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JSC Georgia Capital

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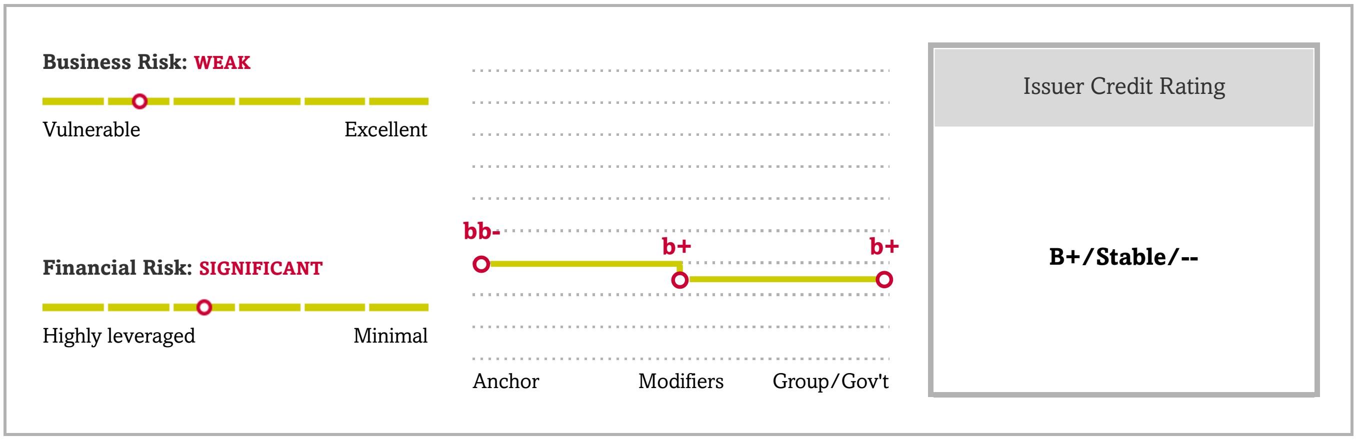


Credit Highlights

Overview

Key Strengths	Key Risks
Financial policy of maximum of 30% loan-to-portfolio value (LTV) ratio at all times.	Limited portfolio size of about $800 million.
Role as an important investment vehicle in Georgia.	Sole exposure to volatile Georgian market.
Share of listed assets of about 45% of the portfolio.	High concentration with three key assets constituting about 65% of the portfolio.
Good competitive position of key investee companies.	Exposure to foreign currency risk on the debt side with earnings largely in local currency.
Adequate liquidity and sustainable debt maturity profile.	On-lending of bond proceeds to investee companies.

Georgia Capital's investment portfolio is fully concentrated on the developing market of Georgia and particularly on three key assets. 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%. Georgia is a developing market that can be quite volatile and relies heavily on net foreign direct investments. We continue to see risks to the Georgian economy from regional geopolitical developments in relation to Russia, but we do not expect a material escalation. In fact, we anticipate the conflict will remain largely frozen over the medium term. Georgia Capital also has relatively high asset concentration in its portfolio. Georgia Healthcare Group, Bank of Georgia, and Georgia Global Utilities, the three largest assets, constitute about 65% of the portfolio.

Relatively small size of the portfolio, weak weighted average credit quality, and on-lending of bond proceeds 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 $800 million, Georgia Capital's investment portfolio is smaller than that of many other rated investment holding companies globally, which increases concentration risks. On-lending of bond proceeds to Georgia Capital investee companies constrains the liquidity of its portfolio, in our view.

The sound financial policy should help to offset the negative effects of foreign exchange fluctuations. We expect Georgia Capital to actively manage its debt levels so that it maintains a maximum of 30% loan-to-portfolio value (LTV) ratio at all times, which includes our expectations that management will be selling listed assets, at a discount if needed, to keep the LTV below 30%. This should help to somewhat offset one of the key risks faced by Georgia Capital--the depreciation of its local currency against the U.S. dollar. Its debt is almost entirely in U.S. dollar bonds, while cash flows of its investee companies are largely in Georgian lari (GEL), with only some embedded natural hedge supported by the generally high level of dollarization of the Georgian economy.

Outlook: Stable

The stable outlook reflects our view that Georgia Capital will actively manage its LTV ratio so that it remains below 30% in the next 12 months. We also expect stable dividend flows from its portfolio companies, which should allow Georgia Capital to comfortably cover its operating and interest expenses, and no on-lending other than US$165 million from the bond proceeds.

Downside scenario

We could lower the rating if Georgia Capital's LTV rises above 30% on a sustained basis and the company does not take immediate action, such as asset sales, to restore balance-sheet strength. LTV deterioration would most likely be the result of a material weakening in equity values or large negative currency fluctuations. Ratings pressure could also result from material credit quality deterioration of any of the core investments, which would erode valuations and increase the likelihood of Georgia Capital having to inject fresh capital for support. We could also lower the rating if there are any signs of liquidity or refinancing risks at either Georgia Capital or its investees.

Upside scenario

We could revise the outlook to positive or raise the ratings if Georgia Capital's portfolio characteristics--such as liquidity, asset quality, and diversification--materially improve. Material portfolio valuation increases resulting in sustained lower LTV ratios--and if management commits to maintaining this--could support a higher rating. An upgrade would hinge on maintenance of at least an adequate liquidity profile.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Georgia of 4.0% in 2019, 3.5% in 2020.
- Interest income of about GEL25 million-GEL40 million annually.
- Dividend income of GEL80 million-GEL95 million annually.
- Operating expenses at the holding company of about GEL20 million and interest expenses of GEL50 million-GEL55 million per year.
- No further material debt incurred at Georgia Capital.

Key Metrics

	2018A	2019E	2020E
Cash flow adequacy (x)	1.8	1.6-1.8	1.6-1.8
Loan to value (%)	25	Less than 30	Less than 30

A--Actual. E--Estimate.

Base-case projections

We expect Georgia Capital's LTV ratio of 25% as of Dec 31, 2018 to remain broadly unchanged in 2019. Georgia Capital will likely continue to operate broadly within its financial policy of 30% maximum leverage. We believe that if it were to deviate from this, it would likely come from a drop in the share prices of core investments rather from a major acquisition. We expect the global economy to enter a period of less supportive macroeconomic conditions and greater instability. This includes Brexit uncertainty, the China/USA trade war, and geopolitical tensions, which could all lead to increased volatility and lower share prices.

Sound cash flow adequacy should provide some buffer against local currency fluctuations.In our base case, we assume sound cash flow ratios of 1.8x for 2019, supported by a total dividend and interest income of about GEL120 million. We expect dividend and interest income to be reinvested into growing investee companies in renewable energy, education businesses, and others.

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 and as of Aug. 1, 2019 had a market value of £364 million. Its portfolio is almost equally split between listed and non-listed equity participations in investee companies in Georgia in banking, pharma and healthcare, utilities, real estate and hospitality, private education, and renewable energy generation. Its key investments include 19.9% of U.K.-listed Bank of Georgia Plc (BOG), 57% of U.K.-listed Georgia Healthcare Group (GHG), 100% of Georgian Global Utilities (GGU), a water utility business; 100% of M2, a real estate and hospitality business; 65% in Georgian Renewable Power Company (GPRC); as well as a 100% stake in Aldagi, a property and casualty insurance company, and a 86% stake in Georgia Beverages, a beverage business.

Business Risk: Weak

It has a sole concentration in the Georgian economy. All Georgia Capital's investee companies are located in Georgia. The Georgian economy remains constrained by relatively low per capita income (estimated at $4,200) and balance-of-payments vulnerabilities, including Georgia's import dependence, high current account deficits (which, however, declined recently), and sizable external debt, which could weigh on Georgia Capital's growth potential. However, we generally assess the macroeconomic factors as supportive for Georgia Capital over the near term, given our expectation of 4.0% real GDP growth in 2019 and 3.5% in 2019 (compared with 4.7% in 2018) and the country's strong institutional arrangements for the region. The agreement for political association and economic integration between the EU and Georgia, which entered into force in 2016, is likely to support Georgia's consumption of products, such as compulsory third-party insurance.

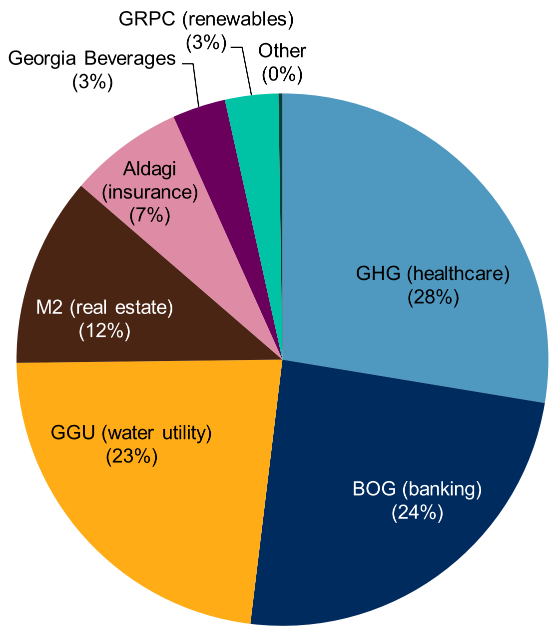
On-lending of bonds proceeds negatively affects liquidity of the portfolio. $165 million of bond proceeds are designated to be on-lent to two investee companies--GRPC and m2--to fund the development of wind power projects and hotel construction. We believe these investments entail some execution risk and are difficult to finance at a reasonable cost on a stand-alone basis in the local capital markets. This is unusual for an investment holding company, given that they typically do not participate in debt financing of investee companies. Such a commitment could reduce the willingness to sell the shares of the investee, even if needed to manage holding-company debt levels.

We also factor in that there is a cross-default clause (with a threshold of $25 million) with "material subsidiaries" of Georgia Capital, which increases the exposure of Georgia Capital to the credit risk of its unlisted investees. We understand that currently no subsidiaries are considered material. We believe this might create a strong incentive for Georgia Capital to support unlisted material subsidiaries if it is experiencing financial stress.

Portfolio analysis.

Chart 1

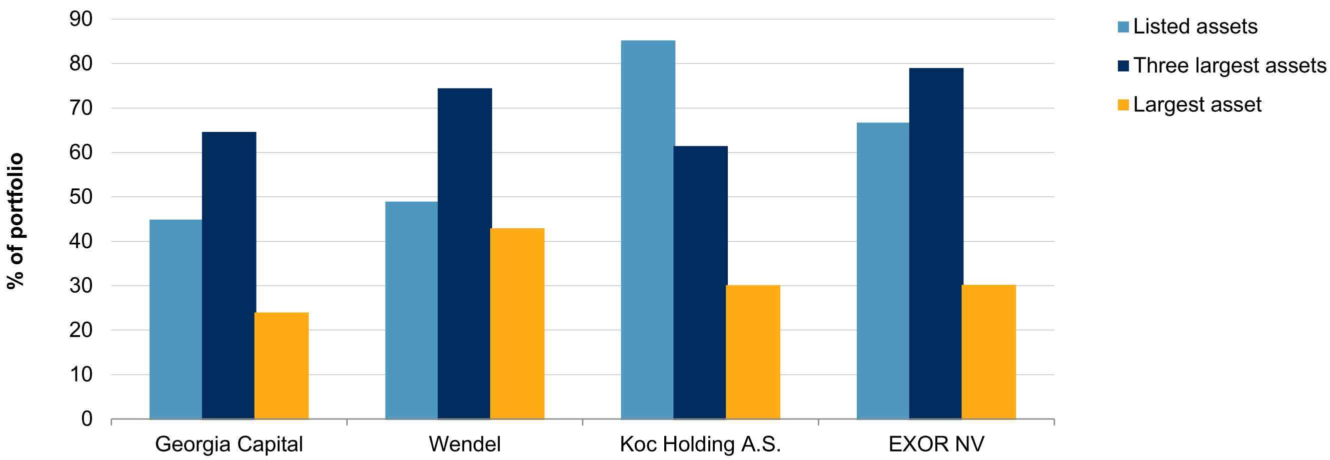
Georgia Capital's Net Asset Value Breakdown By Investment



Source: S&P Global Ratings.

Chart 2

Georgia Capital's Diversification Versus Peers



Source: S&P Global Ratings.

Georgia Capita's key investee companies enjoy good competitive positions in their respective markets. BoG is the largest provider of banking services in Georgia, with a market share of about 40%. GGU is a water utility monopoly in capital city of Tbilisi and surrounding area. GHG is the largest pharma distributor and private owner of hospitals in Georgia with market shares of 30% and 25% in the respective segments. BoG generated about 30% of Georgia Capital's total dividend stream in 2018 and GGU generated about 40%. We expect the share of these two investee companies to gradually decline as companies such as Aldagi and M2 increase their dividends payments, while GHG starts to pay dividends from 2019.

GHG and GGU benefit from mostly having completed their investment programs, which should allow them to generate positive cash flows. At the same time, Georgia Capital's renewable energy company, GRPC, will require large investments over the next three to five years. We consider these investments to be partly funded from dividend and interest income and partly from the proceeds from the issued bond that will be on-lent to GRPC. We also expect Georgia Capital to invest heavily in its education business, as already demonstrated by its purchases of several schools in 2019.

We believe management has demonstrated an ability to develop exit opportunities, such as the initial public offering of GHG in 2015 (bringing in US$110 million), which was Georgia's third IPO overall and its first outside the financial sector. We also factor in that Georgia Capital in May 2017 sold 7.2% of GHG shares for US$40 million. Consequently, we expect Georgia Capital to gradually monetize its shares in GHG and reduce its ownership to below 50%, redeploying the funds into existing or new investments that could support better portfolio diversification.

We note that Bank of Georgia Plc's share price has declined by more than 20% since June 2018 and that of Georgia Healthcare group has declined by about 10% since the same date because of overall price volatility in the emerging markets, but also due to investors reallocating capital from investee companies into newly listed Georgia Capital Plc. However, growth in the portfolio value of unlisted assets, particularly M2 and GGU, has compensated for this decline with the overall portfolio valuation remaining broadly flat. Georgia Capital's share price has remained broadly flat since July 2018, also supported by its share buy backs. Georgia Capital has purchased $45 million of its own shares under its previous buy-back program launched in mid-2018 and announced a new $20 million share buy-back program in August 2019.

In relation to peers, Georgia Capital is a much smaller investment holding company. Additionally, Georgia Capital is more exposed to high country risk environment and local currency volatility. We consider that the performance of investee companies may be affected by the volatility of the economy in the future, which has the potential to decrease the company's cash flow, among other metrics.

Peer comparison

Table 1

Georgia Capital--Peer Comparison

	Georgia Capital JSC	Koc Holding A.S.	Wendel	EXOR N.V.
Issuer credit ratings	B+/Stable/--	BB-/Stable/B	BBB/Stable/A-2	BBB+/Stable/A-2
Business profile	Weak	Fair	Fair	Satisfactory
Portfolio size (adjusted; Mil. $)	810.0	8,502.0	8,059.0	24,828.0
Weight of listed assets (%)	44.7	89.0	48.7	66.5
Largest asset (% of portfolio)	23.8	29.9	42.7	30.0
Three largest assets (% of potfolio)	64.4	61.2	74.2	78.8
Three largest assets	Bank of Georgia, Georgian Global Utilities, Georgia Healthcare Group	Tupras, Ford Otosan, and Yapi Kredi Bank	Bureau Veritas, Stahl, and IHS	FCA Group, PartnerRe, and Ferrari
Cash flow leverage	Significant	Modest	Modest	Modest
Loan to value ceiling (%)	30.0	20.0	20.0	20.0
Loan to value (%)	24.8	(2.5)	6.6	14.4

Financial Risk: Significant

We expect Georgia Capital to actively manage its debt levels so that it maintains a maximum of 30% loan-to-portfolio value (LTV) ratio at all times, including selling listed assets at a discount if needed. Based on current market prices, we assess its LTV ratio will be about 20%-25%. We expect Georgia Capital to use its dividend and interest income stream for capital contributions into renewable energy business, education, and real estate businesses.

Financial summary

Table 2

Georgia Capital JSC.--Financial Summary

(Mil. GEL)	2018
Portfolio as adjusted	2,188

Table 2

Georgia Capital JSC.--Financial Summary (cont.)	
(Mil. GEL)	**2018**
Net debt as adjusted	542
Loan to value (%)	24.8
Dividend and fees income	112
Operating charges and tax expenses	19.0
Interest expenses	44.7
Cash flow cover (x)	1.8

GEL--Georgian lari.

Liquidity: Adequate

We assess Georgia Capital's liquidity as adequate. We estimate that its sources of liquidity cover sources by above 1.3x starting from June 2019.

We believe Georgia Capital has a generally satisfactory standing in credit markets, which is demonstrated by the bond issuance, and that it has sound relationships with local banks, given its important position as a key investor in the country.

Nevertheless, its ability to refinance debt could be restricted, as the domestic capital markets are relatively shallow and Georgia Capital has no committed back-up facilities in place. 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 that principal liquidity sources over the 12 months from June 30, 2019, are as follows:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds) of GEL324 million, 88% held in $); and
- Dividends from portfolio companies and interest income of about GEL110 million.

Principal Liquidity Uses

We estimate that principal liquidity uses over the same period:

- Operating costs of around GEL20 million;
- Interest expenses of approximately GEL50 million-GEL55 million;
- About GEL200 million of equity capital contributions into its investee companies; and
- GEL50 million-GEL70 million of on-lending to investee companies.

Debt maturities

A $300 million bond matures in 2024

Covenant Analysis

The bond documentation contains a maintenance ratio of net debt to adjusted equity value of below 45%. As of March 31, 2019, Georgia Capital had significant headroom within these thresholds.

Issue Ratings - Subordination Risk Analysis

Capital structure

Georgia Capital's capital structure includes the $300 million unsecured bond.

Analytical conclusions

We rate the notes in line with our issuer credit rating on Georgia Capital, because no elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating

B+/Stable/--

Business risk: Weak

- **Country risk:** High
- **Industry risk:** Intermediate
- **Competitive position:** Weak

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bb-

Modifiers

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

Stand-alone credit profile : b+

- **Group credit profile:** b+
- **Related government rating:** BB-

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 And Insurers, 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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	**bb-**	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 6, 2019)*

JSC Georgia Capital	
Issuer Credit Rating	B+/Stable/--
Senior Unsecured	B+
Issuer Credit Ratings History	
05-Jul-2018	B+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.