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Research Update:

Investment Holding Company Georgia Capital JSC Assigned 'B+' Rating; Outlook Stable

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Overview

- Georgia Capital PLC, the parent of Georgia Capital JSC, has completed its separation from BGEO Group PLC, and retained a 19.9% equity stake in Bank of Georgia Group PLC.
- Georgia Capital JSC issued a $300 million bond for refinancing the debt of its former parent, and to fund its investee companies' capital expenditures.
- After the demerger, Georgia Capital has a moderately concentrated investment portfolio worth about $0.9 billion, with a loan-to-value (LTV) ratio of 20%-25% after factoring in a $45 million share buyback program.
- We are assigning our 'B+' ratings to Georgia Capital and its senior unsecured debt.
- The stable outlook reflects our view that Georgia Capital's LTV ratio will stay below 30% over the next 12 months, with stable dividends allowing the company to comfortably cover its operating and interest expenses, and no further onlending other than $165 million from the bond proceeds.

Rating Action

On July 5, 2018, S&P Global Ratings assigned its 'B+' long-term issuer credit rating to Georgia-based investment holding company Georgia Capital JSC. The outlook is stable.

At the same time, we assigned our 'B+' issue rating to the company's $300 million senior unsecured bond.

The ratings are in line with the preliminary ratings we assigned on Feb. 21, 2018 (see "Georgia-Based Georgia Capital JSC Assigned Preliminary 'B+' Rating; Outlook Stable," on RatingsDirect.)

Rationale

Our rating reflects Georgia Capital's limited portfolio size and diversification, as well as its sole exposure to the economic and business development in Georgia (BB-/Stable/B). We expect Georgia Capital to actively manage its debt so that it maintains a maximum LTV ratio of 30% at all times, which includes selling listed assets at a discount if needed. Based on current market prices, we assess its LTV ratio at about 20%-25%, factoring in the $300 million senior unsecured bond, and a Georgian lari (GEL) 40 million ($16 million) guarantee that Georgia Capital issued to secure the debt of subsidiary Teliani, a beer production business.

With a portfolio size of about $0.9 billion, Georgia Capital's investment portfolio remains smaller than that of many other rated investment holding companies globally, which increases concentration risks. We also take a note that the market capitalization of both of its listed assets, Bank of Georgia (BoG) and Georgian Healthcare Group (GHG), which together account for around half of GC's portfolio value, is now around 18% lower than when we assigned the preliminary rating.

Of the bond proceeds, $165 million are designated to be onlent to two investee companies--Georgian Global Utilities (GGU) and m2 Real Estate JSC (m2)--to fund the development of wind power projects and hotel construction. Since the bond issuance, Georgia Capital has already onlent $70 million, of which around $23 million were spent to repay m2's debt, which contained certain unfavorable covenants. This is unusual for an investment holding company, given that they typically don't participate in financing investee companies. Such a commitment could reduce willingness to sell shares of the investee company, even if needed to manage the investment holding company's debt. Also, the bond documentation includes a cross-default clause linked to material subsidiaries, with a $25 million threshold, which might create an incentive for Georgia Capital to use cash for refinancing investee companies' debt. We also believe that investments in investee companies' projects entail some execution risk and are difficult to finance at a reasonable cost on a stand-alone basis in the local capital markets.

We are mindful of the $45 million share buyback program Georgia Capital has announced. We understand that the company expects to hold the repurchased shares on its balance sheet, and believe the cancellation of these shares might weigh on the LTV ratio. We also factor in the market risk related to these shares even if the company continues to hold them on the balance sheet.

In addition, Georgia Capital's investee companies are solely exposed to economic and business conditions in Georgia, which is a developing market that could exhibit significant volatility and is heavily reliant on net foreign direct investments. Moreover, in our view, 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, 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 4.5% real GDP growth in 2018 and 4% in 2019 (compared with 5% in 2017) and the country's strong institutional arrangements for the region. The association agreement for political association and economic integration between EU and Georgia, which entered into force in 2016, will likely bolster Georgia's consumption of products, such as compulsory third-party insurance.

In our view, local-currency depreciation versus the U.S. dollar is a key risk for Georgia Capital. Its bond is issued in U.S. dollars, whereas the cash flows of its investees are largely in lari, with only some embedded natural hedge supported by the Georgian economy's generally high level of dollarization. Historically, the lari has demonstrated large swings versus foreign currencies, which could materially increase Georgia Capital's debt in local currency and rapidly erode any headroom in the company's LTV ratio. The company holds its cash balances in foreign currencies, however, which buffers negative exchange-rate fluctuations. We also factor in that GGU's new renewables division Georgian Renewable Power Company JSC (GRPC) benefits from renewable energy purchase power agreements signed in U.S. dollars, and that m2 set its hotel room prices in U.S. dollar equivalent.

We continue to assess Georgia Capital's portfolio as weak, due to its small size, its high concentration in three key assets, and the weighted average credit quality of investee companies in the 'B' category. GHG, BoG, and GGU, the three largest assets, constitute about 70% of the portfolio. GHG and BoG are listed on the London Stock Exchange, which we believe provides better liquidity and, consequently, the ability for Georgia Capital to readily monetize partial stakes if needed to manage its debt levels. Other assets--like insurance company Aldagi and water utility GGU--would take significantly longer to monetize if needed, as they are unlisted and 100% owned. This weighs on our assessment of the portfolio's liquidity.

Additionally, Georgia Capital is a very important investment vehicle in Georgia, given that, according to management, its investee companies' share of Georgia's GDP is about 10%. BoG, where Georgia Capital holds a 19.9% share after the demerger, has the strongest credit quality among Georgia Capital's investee companies, in our assessment. BoG has a good business position, being the largest provider of banking services in Georgia, with a market share of about 40%. We expect that BoG will generate about 30%-40% of Georgia Capital's total dividend stream.

GGU's water unit benefits from having completed a large investment program that should allow it to generate positive cash flows that can be distributed as dividends to Georgia Capital. We expect dividends from GGU will account for 30%-40% of Georgia Capital's total dividend stream. At the same time, GGU's GRPC, will require large investments over the next three to five years.

We also factor in that that GHG, of which Georgia Capital holds 57%, is actively expanding in both the pharmaceutical retail segment, where it generated about 60% of revenues in 2017, and health care, due to the ramp-up of the two hospitals renovated through 2016-2017. As a result of these investments, GHG had financial leverage of about 4x on an S&P Global Ratings-adjusted basis in 2017. Due to relatively high financial leverage, we believe GHG's ability to upstream dividends is limited.

We believe management has demonstrated an ability to develop exit opportunities, such as the IPO of GHG in 2015 (bringing in $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 a 7.2% share in GHG for $40 million. Consequently, we expect Georgia Capital to gradually monetize its shares in GHG and reduce its ownership to below 50%, to fund existing or new investments that could support better portfolio diversification.

In our base case, we assume:

- Real GDP growth in Georgia of 4.5% in 2018, averaging 4.0% in 2019-2020.
- Interest income from onlent funds of about GEL20 million annually.
- Dividend income of GEL60 million-GEL70 million annually.
- Operating expenses at the holding company level of GEL20 million and interest expenses of GEL45 million-GEL50 million per year.
- A GEL40 million guarantee issued by Georgia Capital for its Teliani business.
- No further debt incurred at Georgia Capital.
- Share buybacks of $45 million in 2018 (GEL113 million).

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

- An LTV ratio of around 23%.
- Cash flow adequacy ratio close to 1.1x in 2018 and 2019.

Liquidity

We assess Georgia Capital's liquidity as adequate. We estimate that its sources of liquidity cover sources by above 1.2x starting from June 2018. Our calculation factors in the $300 million bond issuance and proceeds from the bond used for refinancing of debt at the holding company level. We also assume onlending of $165 million, out of which $70 million have already been onlent.

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 and through its investment in BoG.

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.

We estimate that principal liquidity sources over the 12 months from June 30, 2018, are as follows:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds) of about GEL155 million, pro forma the onlending of $165 million, and including $25 million of own bonds purchased from the market; and

- Dividends from portfolio companies and interest income of about GEL90 million.

We estimate that principal liquidity uses over the same period:

- Operating costs of around GEL20 million;
- Interest expenses of approximately GEL45 million-GEL50 million; and
- A GEL113 million ($45 million) share buyback announced in June 2018.

The bond documentation contains a maintenance ratio of net debt to adjusted equity value of below 45%. As of March 31, 2018, this ratio was just above 15%, with significant headroom within these thresholds.

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 investees. We understand that currently no subsidiaries are considered material. We believe this creates a strong incentive for Georgia Capital to support GGU in case it is experiencing financial stress.

Outlook

The stable outlook reflects our view that 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 flow from BoG and GGU, which should allow Georgia Capital to comfortably cover its operating and interest expenses, and no onlending other than $165 million from the bond proceeds.

Downside scenario

We could lower the rating if Georgia Capital's LTV rises above 30% for a prolonged period 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 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. We could also lower the rating if there are any signs of liquidity or refinancing risks at the level of 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 portfolio diversification--materially improve. In addition, material portfolio valuation increases resulting in sustained lower LTV ratios and to which management commits to maintaining could support a higher rating. An upgrade would hinge on maintenance of at least an adequate liquidity profile.

Issue Ratings--Subordination Risk Analysis

Capital structure

GC'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
- Investment position: Weak

Financial risk: Significant
- Cash flow/Leverage: Intermediate

Anchor: bb-

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

Stand-alone credit profile: b+
- Group credit profile: b+
- Sovereign rating: BB-

Related Criteria

- 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 - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, 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
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Georgia-Based Georgia Capital JSC Assigned Preliminary 'B+' Rating; Outlook Stable, Feb. 21, 2018

Ratings List

New Rating

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

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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. 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.