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Research Update:

Georgia Capital 'B+' Rating Affirmed On Partial Voluntary Bond Cash Tender Offer; Outlook Remains Negative

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Rating Action Overview

- On Oct. 14, Georgia-based investment holding company Georgia Capital JSC (GC) launched a cash tender offer of up to $60 million on a voluntary basis, for its $365 million senior unsecured notes due in March 2024.
- We view the transaction as opportunistic treasury management, reflecting the holding company's sound liquidity and cash balance of Georgian lari (GEL) 663 million as of the end of June 2022 which covered about 60% of its total gross debt. In addition, although notes will be repurchased slightly below par, in the 88%-95% range, we believe this is not materially different from the current bond trading and pricing levels we see in the emerging bond market.
- Positively, the group's portfolio value stabilized since the onset of the Russia-Ukraine war, reaching GEL2.7 billion on June 30, 2022, up 3.7% since end-March 2022; and its leverage is moderate, with an S&P Global Ratings-adjusted loan-to-value (LTV) ratio of 17.0% at June 30, 2022.
- We therefore affirmed our 'B+' long-term issuer credit and issue rating on the company and its debt.
- The outlook is negative because we could downgrade GC in the next six-to-nine months if the company fails to enact a credible plan to refinance its 2024 bond maturity.

Rating Action Rationale

Positive momentum in the Georgian economy and business environment should support GC's asset valuations and dividend payments over 2022-2023. The influx of migrants since the onset of the Russia-Ukraine war and a wider tourism recovery have lifted immediate growth prospects. We now forecast the Georgian economy to grow by 8% in 2022 (from our 4% forecast in July 2022), moderating to 3% next year, with some migrants possibly leaving and Georgia facing increasing headwinds from the slowing global economy (for more information, see "Georgia 'BB/B' Rating

Affirmed; Outlook Stable," published Aug. 26, 2022, on RatingsDirect). Positively, GC's portfolio value stabilized in the second quarter, showing an increase of 3.7%, following the sharp drop in first-quarter 2022 of 12.4% because of the war. As a consequence, the group's LTV ratio was broadly stable, at 17.0% at June 30, 2022, compared with 17.5% at first-quarter-end (excluding the shareholder loan which has now been repaid) and 12.5% at year-end 2021 (pro forma the proceeds from the sale of the water utility business). The positive momentum in the Georgian economy also leads us to expect that the group's cash adequacy ratio will likely remain at about 1x in 2022 and in 2023, with dividend inflow of GEL90 million-GEL100 million in 2022, moderately improving in 2023.

GC retains a comfortable liquidity buffer, but the notes mature in less than 18 months and the capital market conditions remain uncertain. The group enjoys a solid liquidity buffer since its disposal of 80% of Georgian Global Utilities JSC (GGU) in the beginning of the year, when it received $180 million, and we do not anticipate imminent liquidity risk. GC's sources of cash will, however, likely not cover cash outlays absent a proactive refinance of its $365 million bond. Based on figures as of June 30, 2022, the group's cash covers about 60% of its maturity. We view the company's ambition to lower its debt as positive, and the current bond repurchase crystallizes its intent. We understand that year-to-date, GC opportunistically bought back about $70 million of its $365 million bond at market price. If it tenders $60 million, it'll still have $235 million maturing in March 2024. At the same time, credit conditions remain uncertain and bond markets for high yield issuers are virtually shuttered. However, the local market seems available, as demonstrated by the recent bond issuances by the group's renewable and housing businesses at attractive rates. Positively, 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. Conversely, all its dividend income is GEL-denominated, excluding the renewable energy business that has cash flow in dollars and consequently pays divided in hard currency. The GEL has appreciated 11.7% since the beginning of the year.

The company has launched a tender offer on its senior secured notes below par, but we assess this as opportunistic liability management. The offer follows Georgian Renewable Power Operations (previously owned by GGU) closing of a $80 million green secured bond Oct. 12, 2022, and subsequent repayment of the shareholder loan from GC. We understand the group now intends to use part of this cash for the tender offer where they target $60 million of its $365 million notes maturing in March 2024, and proactively handling the upcoming maturity. The tender price is 88%-95%, which is below par, meaning that bondholders that opt to participate will receive a discount on face value. However, the company is not buying back below market price, and we don't view the tender as a distressed transaction because the current market price of 93%-95%, is broadly in line with how 'B' rated notes are trading currently. The notes have been trading slightly below par, at 93%-98%, since the start of the Russia-Ukraine conflict. Finally, the company doesn't face risks of conventional insolvency over the next few quarters, if the offer isn't accepted. Furthermore, although we see risks in the group's upcoming maturity wall in March 2024 when the notes mature, we still believe GC would have time and alternatives to refinance this debt, bolstered by its cash buffer and solid standing in the local market.

Outlook

The negative outlook reflects the possibility of a downgrade in the next six-to-nine months given the risks from the 2024 bond maturity.

Downside scenario

We could downgrade GC if the company fails to enact a credible plan to address the maturity or capital market conditions materially worsen. Under this scenario, we might see:

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

We would also downgrade GC if the company undertakes any repurchases, exchanges, consent solicitation, or other liability management activities regarding its 2024 note that we deem distressed, which we do not expect.

Furthermore we could lower the rating if the Georgian economy unexpectedly deteriorates, causing:

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

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 as well as a long-dated debt maturity profile;
- The LTV ratio 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 also has a put option on its remaining 20% stake in the water utility business, with a highly observable value 2022, which stood at GEL135 million at June 30, 2022. 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 8% in 2022 and 3% in 2023.
- 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 in second-half 2022, but not in 2023.

Liquidity

We assess GC's liquidity as adequate. We estimate that its sources of liquidity cover its uses by about 4.9x from July 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 because the domestic capital markets are relatively shallow, and the group has no committed backup facilities.

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

- Cash and cash equivalents of GEL663 million as of June 30, 2022 (mostly sovereign and Georgian corporate bonds denominated in U.S. dollars).
- 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 about GEL30 million.
- Interest expense of about GEL30 million.
- Discretionary share repurchases of about GEL12 million in 2022.
- Bond buyback of $60 million (about GEL165 million).

Covenants

The bond documentation only contains an incurrence ratio of net debt to adjusted equity valued below 45%. We believe 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 GC because all its investments concentrate in a single emerging market, namely Georgia, which we view as having high country risk. The group's governance benefits from a diversified institutional ownership with no single controlling shareholder, a very high share of independent directors (six out of the seven 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. The group's major sector exposure is represented by a retail pharmacy (25% 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 the group, 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	Moderately high
Industry risk	Intermediate
Competitive 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)

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

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Georgia Capital JSC	
Issuer Credit Rating	B+/Negative/--
Senior Unsecured	B+