MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns B2 rating to JSC Georgia Capital's $50 million notes, outlook stable

08 Mar 2021

Frankfurt am Main, March 08, 2021 -- Moody's Investors Service ("Moody's") has today affirmed JSC Georgia Capital's ('GCAP') probability of default and corporate family rating at B2-PD and B2 respectively. Concurrently the agency has affirmed the B2 instrument rating of the $300 million of senior unsecured notes issued by GCAP and assigned a B2 rating to the $50 million tap under the existing notes. The outlook has been changed to stable from negative.

RATINGS RATIONALE

The affirmation of GCAP's rating at B2 and the change in outlook to stable was prompted by (i) the material improvement in operating performance of GCAP's underlying investments during the second half of calendar year 2020, (ii) a significant reduction in market value leverage, (iii) a disciplined capital allocation during the pandemic, and a (iv) a stronger business outlook for the next 12 to 18 months than back in June 2020 when we revised our outlook to negative.

The operating performance of all of GCAP's underlying investments apart from the water utility business recovered sharply during the second half of 2020. The improvement in operating performance was both driven by higher revenue and improved profitability. At the aggregated level, GCAP's private portfolio of investments posted revenue growth of 4.7% in Q3 2020 and 5.1% in Q4 2020 respectively. Aggregated EBITDA of private investments grew 4.5% in Q3 2020 and 1% in Q4 2020. GCAP's water utility business posted a 14.9% / 28.2% decline in revenue in Q3 / Q4 2020 respectively due to weak consumption from corporate clients and low water inflows at the Zhinvali reservoir. We positively note the new regulatory water tariff for the period 2021 to 2032 that will allow up to 38% increase in allowed revenue from water sales.

The strong improvement in profitability in H2 2020 alongside an improvement in valuation multiples in line with the broader market and the exchange offer for GHG led to a significant improvement in GCAP's gross asset values. Gross asset value increased to GEL 2.9 billion in December 2020 from GEL1.8 billion in March 2020 with the revaluation of GHG and the increase in GCAP's stake in this asset post exchange offer accounting for the largest share of improvement (GEL563 million positive impact on GAV). Market value leverage also improved markedly to around 30% in December 2020 from 47% in March 2020 (40% pro forma of the exchange offer and pre revaluation) as GCAP significantly reduced its capital allocation to protect its balance sheet since the start of the pandemic. GCAP's MVL of 30% offers sufficient headroom in comparison to our downgrade trigger of 40% and also against the risk of a deterioration in valuation multiples across the broader market over the next 12 to 18 months.

GCAP has swiftly reacted to the coronavirus pandemic by adjusting its capital allocation and by focusing on reducing its operating expenses. GCAP made investments of GEL 195 million in 2020 (including GEL138 million of non-cash capital allocation), a significant reduction in comparison to the investments of GEL 358 million made in 2019. Operating expenses were reduced to GEL32.1 million in 2020 (including share based payments) from GEL34 million in 2019. GCAP has confirmed in its Q4 earnings call that capital allocation in 2021 will remain at a low level. We expect GCAP to allocate around $35 million of the bond proceeds to investments for its education and renewable energy business. The remainder will be kept on balance sheet to strengthen the group's liquidity profile. This is important in the context of a still weak dividend cover, albeit we expect dividend distribution to improve going forward as its investments continue to benefit from improving operating conditions.

The business outlook for GCAP's underlying investments is more settled than it was back in June 2020 when we changed the outlook to negative. Georgia has seen a consistent reduction in coronavirus infections since a peak reached early December 2020. This has enabled a gradual reopening of the economy. Preliminary data from the National Statistics Office indicates that Georgia's economy shrank by 6.1% in 2020, as the global coronavirus pandemic weighed on the country's small, open economy. Going forward, our sovereign team expects gradual reopening of Georgia's borders - quarantine free travel is currently only available to three member states of the European Union (Aaa stable) - combined with a significant base effect, to drive a partial recovery in real GDP growth of around 4.8% in 2021.

LIQUIDITY

GCAP's liquidity is adequate. GCAP had GEL 284 million ($86 million) of liquidity (including cash, loans issued and marketable securities) on balance sheet at year-end 2020 (21% decline y-o-y) mainly as a result of a lower dividend stream (GEL30 million dividend income versus GEL122 million in 2019). The cash position compares to operating expenses of GEL 30 million p.a. and net interest expense of around GEL40 million p.a. GCAP has no short-term maturities and expects dividend income of at least GEL60 million in 2021.

The liquidity at underlying investments increased sharply in 2020 to GEL392 million at year-end 2020 from GEL183 million at year-end 2019. This was supported by strong underlying operating cash flow generation (GEL376 million operating cash flow in FY20 versus GEL230 million in FY19) and the issuance of a green bond at the utilities business. There are no material short-term maturities at portfolio level that cannot be covered from cash on balance sheet.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Positive pressure on the rating is not anticipated in the short-term due to the remaining uncertainties related to coronavirus pandemic. Longer term positive pressure could arise if JSC Georgia Capital would demonstrate a prolonged track record of successfully managing a portfolio of investments with a good balance between defensive / growth investments as well as between listed / private assets whilst generating value. We would expect the issuer to maintain a market value leverage of below 35% at all times during the market cycle and an interest cover sustainably well in excess of 2.0x to consider a higher rating. The maintenance of a strong liquidity position over time would also be a requirement for a higher rating.

Negative pressure would arise on the rating if JSC Georgia Capital fails to maintain its MVL below 40% and if its interest cover would remain sustainably below 2.0x leading to a deterioration of Georgia Capital's liquidity position. Any cash calls or support requirements for underlying investments would also lead to negative pressure on Georgia Capital's rating.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Investment Holding Companies and Conglomerates published in July 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1125855. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Stanislas Duquesnoy
Senior Vice President
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Anke Rindermann
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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