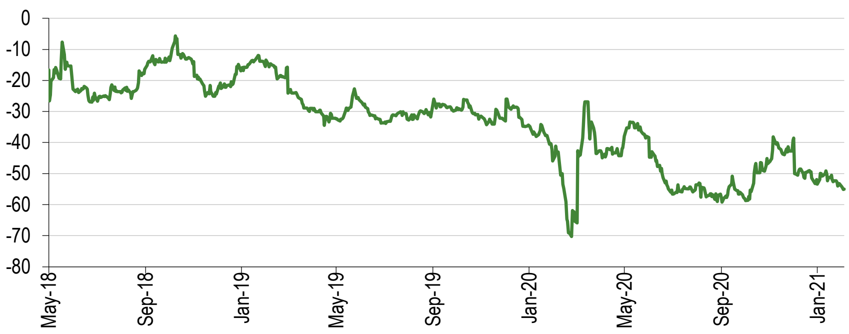
Georgia Capital

Solid positive revaluations in Q420

Investment companies
Private equity

Georgia Capital (GCAP) posted a 27.2% NAV total return (TR) in local currency terms in Q420 on the back of solid valuation uplifts across all key portfolio holdings. This, together with the Q320 revaluation of GHG after it was made private (see our initiation note for details), offset the weak performance of GCAP's hospitality and commercial real estate business and the subdued share price performance of Bank of Georgia in 2020. Consequently, GCAP's FY20 NAV TR reached 2.7% in local currency (though -13.3% in sterling terms). The NAV uplift helped reduce GCAP's loan-to-value (LTV) at the holding level from 44.1% at end-March 2020 to 28.9% at end-2020. GCAP's new investments remain centred around renewable energy and education.

GCAP's historical discount to NAV



Source: Refinitiv, Edison Investment Research

Why invest in Georgia Capital now?

While COVID-19 resulted in a real GDP decline of c 6.1% in 2020 (according to estimates from the National Bank of Georgia), the IMF expects a 4.3% rebound in 2021 and a return to the 5%+ pa growth path beyond 2021. Despite the collapse in tourism revenues, Georgia's fiscal deficit and external balance seem to be covered by support from international financial institutions (the IMF in particular), as well as strong remittances. GCAP provides geared exposure to the Georgian economy at a wide discount to NAV, mostly through resilient, market-leading businesses in the healthcare services, pharmacy, insurance, water utility, renewable energy and education sectors.

The analyst's view

The market seems to have ignored/overlooked GCAP's strong 27.2% NAV uplift in Q420 (driven by all major holdings), which led to a further widening of its discount to NAV to 55% (see chart above) vs an average discount for UK-listed private equity trusts of c 10–20%. This may be partially justified by the lack of any major portfolio exits, with management expecting to close the first deal in 18–24 months, which would validate its investment strategy. Having said that, we note that 82% of GCAP's portfolio is now externally valued and GCAP buyers are currently receiving a wide discount for their patience. Meanwhile, GCAP may use any excess cash for NAV-accretive buybacks (as it has done in the past).

5 March 2021

Price		**486.5p**
Market cap		**£223.7m**
NAV		**£496.9m**

NAV*		1,081p
Discount to NAV		55.0%
*At 31 December 2020.		
Yield		0.0%
Ordinary shares outstanding		46.0m
Code/ISIN		CGEO/GB00BF4HYV08
Primary exchange		LSE Premium
AIC sector		N/A
52-week high/low	709p	345p
NAV high/low	1,081p	741p
Gross gearing*		44.4%
Net gearing*		36.5%
*As at 31 December 2020		

Fund objective

Georgia Capital focuses on scalable private equity opportunities in Georgia. These opportunities have the potential to reach at least GEL0.5bn equity value over the next three to five years and the company can monetise investments through exits as investments mature.

Bull points

- Majority of portfolio exposed to resilient and well-established businesses.
- Georgia is likely to continue its secular trend with 5%+ real GDP growth after COVID-19.
- Regular dividend income from several portfolio companies.

Bear points

- No track record of investment realisations.
- Concentrated portfolio exposed to a frontier economy is inherently higher risk.
- Vaccination rollout in Georgia has not started yet.

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Market outlook: Lockdown measures gradually lifted

Georgia's real GDP declined by 6.1% y-o-y in 2020 based on estimates from the National Bank of Georgia (NBG), with tourism revenues (representing 11.6% of GDP in 2019) dropping by c 83% y-o-y. Amid the worsening macro environment and COVID-19 support measures, Georgia's fiscal deficit reached more than 9% of GDP in 2020, according to NBG. However, support from international financial institutions (in particular, the Extended Fund Facility from the IMF) helped fund the deficit and cover external imbalances. The latter were further mitigated by higher remittances (up 8.8% y-o-y in 2020 based on NBG data on the back of a strong H220), as well as a bigger decline in imports (-15.9% y-o-y) than exports (-12% y-o-y). Consequently, Georgia's foreign currency reserves reached record-high levels (up 11.5% y-o-y in 2020), allowing the central bank to carry out FX interventions to provide greater stability to the Georgian lari exchange rate after its initial fall during the COVID-19 outbreak (it nevertheless depreciated by c 13% against the US dollar in 2020). The IMF expects Georgia's real GDP to grow by 4.3% and 5.8% in 2021 and 2022, respectively (and forecasts 5%+ pa for 2023–25). Fitch (which has a similar GDP forecast for 2021) expects this year's recovery to be mostly driven by domestic demand as it forecasts tourism revenues to reach only 30% of 2019 levels (80% in 2022). Fitch reaffirmed Georgia's long-term foreign currency issuer default rating of BB with a negative outlook in February 2021.

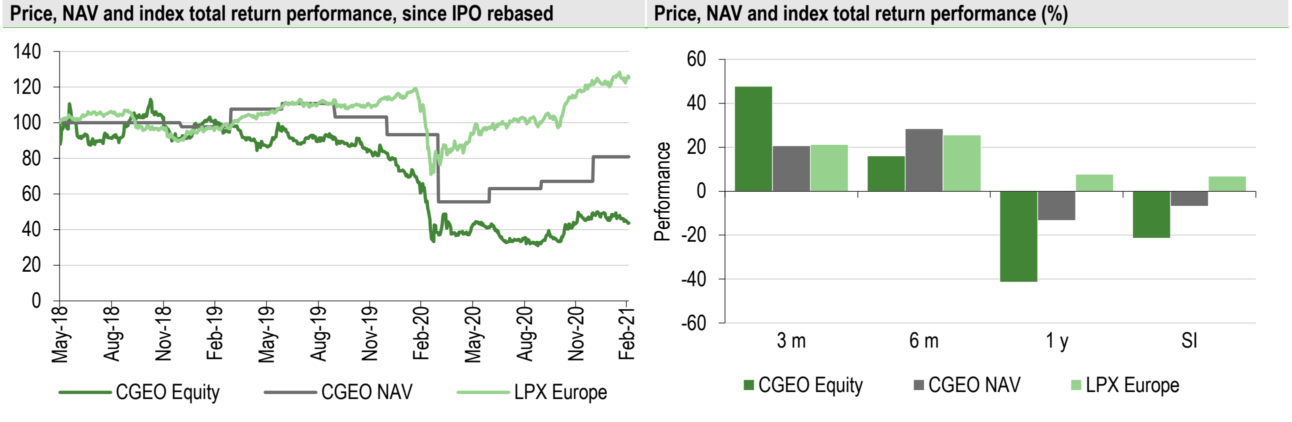
Georgia is preparing to commence vaccination of medical workers and the most vulnerable sections of the population in March (according to the IMF) following modest deliveries of the Pfizer-BioNTech and AstraZeneca vaccines. A larger vaccine roll-out (possibly around end-March or the beginning of April) will take place after the country receives 1.4m doses as part of the World Health Organization's COVAX facility (a global initiative aimed at equitable access to COVID-19 vaccines), sufficient to cover c 20% of the country's population. The government aims to vaccinate 60% of the population by the end of 2021. Meanwhile, it started to gradually lift COVID-19 containment measures in early February in response to a declining number of cases in the country (currently below 1,000 new cases per day vs around 5,000 at the peak of the second wave in December despite an increase in average daily tests). Moreover, Georgia reopened its borders to vaccinated foreign travellers in February.

At the same time, we note the recent political unrest associated with the arrest of the Georgian opposition leader Nika Melia, which triggered Giorgi Gakharia's decision to resign as prime minister on 18 February 2021.

Performance: Slightly positive NAV TR in Georgian lari

GCAP posted a 13.3% decrease in net asset value (NAV) in FY20 in sterling terms, significantly behind the LPX Europe, which increased by 8% during the period. The weakness of the Georgian lari against sterling played an important role, as GCAP's NAV in local currency increased by 2.7% y-o-y, broadly in line with the 1.9% posted by the LPX Europe in its base currency (euro). The potential strengthening of Georgian lari would be supportive of GCAPs performance, and we believe this depends on the economy returning to normal, including revival of tourism as the country recovers from the COVID pandemic.

Exhibit 1: Georgia Capital performance to 31 December 2020 in sterling terms

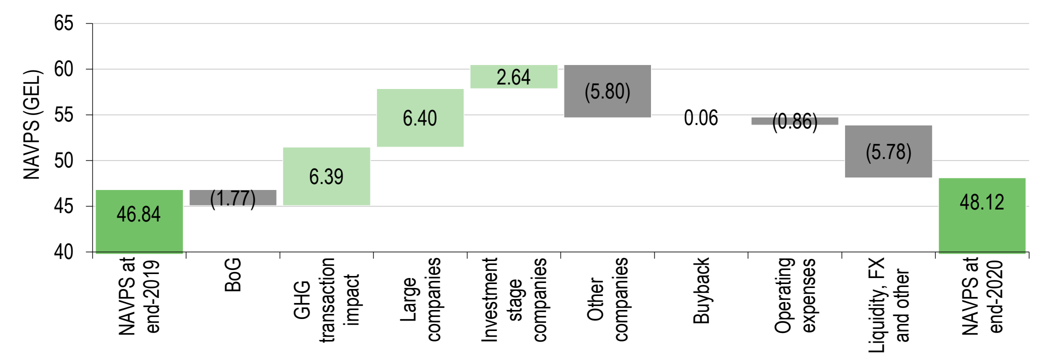


Source: Thomson Datastream, Edison Investment Research. Note: Performance since IPO annualised.

Most of GCAP's key portfolio companies withstood the crisis relatively well, with changes in portfolio valuation adding GEL7.86 to its NAV per share in FY20 (16.8pp to NAV TR), although contributions varied across holdings (see Exhibit 2 and Exhibit 3 for current exposures). Major positive drivers include Georgia Healthcare Group's (GHG's) revaluation as a result of its delisting (even after accounting for the dilutive effect of the transaction), as well as a combination of earnings growth and valuation multiples expansion in the case of GCAP's large portfolio holdings. Investment-stage businesses (renewable energy and education) were an additional positive driver. By contrast, GCAP's hospitality and commercial real estate business, which represents most of the 'other companies' pool (and made up c 11% of GCAP's overall portfolio at end-2019) was visibly affected by COVID-19. Furthermore, the Bank of Georgia (BoG), GCAP's only listed exposure at present, saw its share price decline by c 25% in 2020.

GCAP's operating expenses were 6.6% lower year-on-year in FY20 and translated into an ongoing charge ratio of 1.6% of average NAV (2.0% in FY19). The company targets a management fee of below 2% of its market capitalisation, which amounted to 1.8% in FY20 (FY19: 1.8%). Together with administrative expenses, it stood at 2.8% (FY19: 2.4%). GCAP's NAV in FY20 was also reduced by an FX loss incurred on its US$300m bond.

Exhibit 2: NAV per share development in FY20 (GEL)



Source: Refinitiv, GCAP, Edison Investment Research

82% of portfolio now valued externally

Starting from Q420, all GCAP's large portfolio companies are valued externally by valuation company Duff & Phelps using a blended DCF and market multiples method. The three GHG business lines (healthcare services, retail pharmacy and medical insurance) were valued externally in Q320 for the purpose of the transaction to make it private, while the water utility and P&C insurance businesses were valued by Duff & Phelps for the first time in Q420. Consequently, after accounting for the stake in the listed BoG (valued based on closing price at the NAV date), around 82% of GCAP's portfolio was valued externally at end-2020 (see Exhibit 3). Please note that last 12-month (LTM) valuation multiples represent figures implied by the blended valuation approach.

Exhibit 3: GCAP's portfolio summary at end-December 2020

	Carrying value		As % of total portfolio	Valuation multiple	Valuation method
	(GELm)	(US$m)			
Bank of Georgia	**532**	**118**	**18%**	**-**	**Public markets**
Large portfolio companies	**1,858**	**414**	**64%**	**-**	**External**
Healthcare Services (GHG)	572	127	20%	13.2x LTM EV/EBITDA*	External
Retail (pharmacy, GHG)	553	123	19%	9.1x LTM EV/EBITDA*	External
Water Utility (GGU)	471	105	16%	9.4x LTM EV/EBITDA**	External
Insurance (P&C and Medical (GHG))	263	58	9%	11.6–10.1x LTM P/E***	External
Investment-stage portfolio companies	**303**	**67**	**10%**	-	**Internal**
Renewable Energy (GGU)	210	47	7%	9.7x EV/EBITDA****	Internal
Education	93	21	3%	12.5x LTM EV/EBITDA	Internal
Other portfolio companies	**215**	**48**	**7%**	**-**	**-**
Total portfolio value	**2,908**	**647**	**100%**	**-**	**-**
Net debt*****	(698)				
Net other assets/liabilities	3				
NAV	**2,212**				
NAV per share (GEL)	**48.12**				

Source: Company data. Note: External valuation carried out by Duff & Phelps. *LTM EV/EBITDA multiples for Healthcare Services and Retail (Pharmacy) are presented including the IFRS 16 impact as at end-December 2020. **Calculated based on adjusted LTM EBITDA – reflecting new tariffs announced in 2020 and adjusted for low-volume sales due to COVID-19 reimbursed under the tariff setting methodology. ***11.6x for P&C Insurance business and 10.1x for Medical Insurance. ****Blended multiple for Hydrolea Hydro Power Plants (HPPs) and Qartli wind farm valued using run-rate EBITDA and related EV/EBITDA multiple (Mestiachala HPPs and other pipeline projects valued at cost). *****Cash and equivalents used to calculate net debt include loans issued to portfolio companies as per GCAP's methodology.

Q420 NAV up 27.2% driven by all major holdings

In Q420 alone, GCAP posted a significant NAV uplift of 27.2%, with the positive revaluation of private companies contributing 19.6pp and the 36.6% increase in the share price of BoG to 1,220p adding 9.9pp (now at 1,010p). We note that the majority (c 72%) of the positive valuation impact in the case of private holdings came from operating performance and 28% came from multiples and FX.

Bank of Georgia: Sustained loan book momentum

According to preliminary figures, the BoG's loan book increased 18.9% y-o-y in FY20 (10.2% y-o-y at constant currency), supported by strong loan origination in corporates, micro, small and medium enterprises (MSMEs) as well as mortgages in the retail segment (encouraged by government programmes). In the period, client deposits and notes were up 39.1% y-o-y (28.6% y-o-y in constant currency). Return on average equity (ROAE) declined to 13.0% in FY20 from 26.1% in 2019, reflecting COVID-19 related provisions in Q121, with BoG delivering an annualised ROAE in excess of 20% in each of the remaining quarters of 2020. The non-performing loan (NPL) ratio increased to 3.7% from 2.1% at end-FY19. Due to COVID-19, no dividend was paid for 2019 and the resumption of dividend payouts will depend on the new capital requirements scheduled to be released by the NBG (with the next meeting scheduled for 2 June 2021). That said, BoG has confirmed its medium-term targets for ROAE of at least 20%, loan book growth of c 15% pa and a 25–40% dividend payout ratio.

Healthcare services: Higher LTM EBITDA and debt reduction supporting valuation

The healthcare services business (5.7pp NAV TR attribution in Q420) was revalued on the back of positive operating performance (+2.3pp), as the LTM EBITDA used in the multiples valuation (blended with a DCF-derived value) was rolled from end-June 2020 (used in Q320) to end-December 2020. After a weaker Q220 due to lower bed occupancy, its revenues went up by 3.3%

y-o-y and 13.3% y-o-y in Q320 and Q420, respectively (adjusted for the High Technology Medical Centre, University Clinic (HTMC) disposal in August 2020), with the latter driven by a 9.3% y-o-y increase in admissions to clinics, a 3.6pp y-o-y increase in occupancy rate in hospitals and strong growth in diagnostics revenues. The business also benefited from income tax relief for businesses that retain workers on low wages. By contrast, material expenses were negatively affected by FX and higher consumption of medical disposables and personal protective equipment at healthcare facilities due to COVID-19.

We note that 10 healthcare facilities (out of 51), four clinics and six hospitals are earmarked exclusively for COVID-19 patients (with another 10 healthcare facilities operating a hybrid set-up). Treatment costs are reimbursed by the government and GCAP's business also receives a fixed fee for each bed occupied by a COVID-19 patient. However, based on a discussion with management, we understand that the EBITDA margin per 'COVID-19 bed' is c 12–15% compared to 25–27% for a 'non-COVID-19 bed'. After the initial decrease in Q220, occupancy rates at hospitals returned to pre-COVID-19 levels (up 3.6pp y-o-y in Q420). Consequently, EBITDA (ex-IFRS 16) went up in Q320 by 14.0% y-o-y, while declining slightly by 1.6% y-o-y in Q420. The valuation was also supported by a 25.5% y-o-y net debt reduction to GEL211.2m, partially on the back of proceeds from the HTMC disposal completed during 2020.

Other large portfolio holdings also supporting GCAP's NAV growth

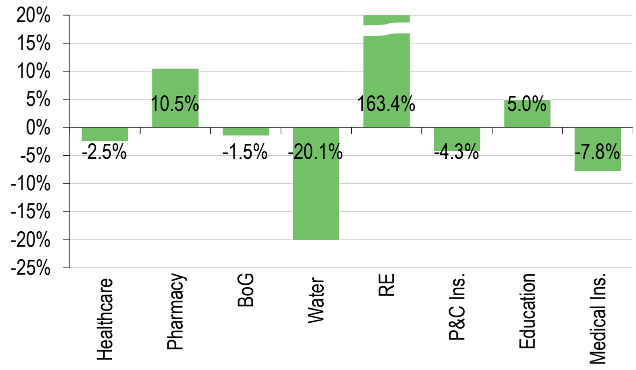
The retail pharmacy business (which contributed 4.5pp to GCAP's NAV TR in Q420) proved particularly resilient with revenues up 10.5% in FY20 (16.4% y-o-y in Q420) including like-for-like growth of 6.1% (9.2% in Q420), assisted by higher average bills (up 17.9% y-o-y in FY20). The EBITDA margin was down only slightly in FY20 to 10.4% from 10.6% in FY19, still ahead of the company's target of 9%. On top of this, the implied LTM EV/EBITDA valuation multiple for the business increased in Q420 from 8.7x to 9.1x.

The water utility business contributed 4.0pp to NAV TR after accounting for the new 2021–23 water tariffs approved in December 2020 by the local regulator, which translate into 38% higher allowed water revenues for the business. The tariffs were set at a level that allows the business to recover unearned revenues in the last regulatory period (2018–20), particularly from the 13% y-o-y decline in water supplies in FY20 amid COVID-19 (mainly due to lower demand from corporate clients). The new tariffs assume a return on investment of 14.98%, in line with the business's mid-term target return on invested capital (ROIC) of 13–15%. We note that its external electricity revenues were down 70.8% in FY20 due to extraordinarily low precipitation-related water inflows to Zhinvali Hydro Power Plant (HPP), leading to a 35% y-o-y decline in electricity generation (while self-produced electricity consumption was up 0.7% in FY20). After retrospectively applying the new tariffs to the business's results, its operations were valued at an LTM EV/EBITDA of 9.4x at end-2020 (vs 10.0x at end-September 2020).

The P&C insurance business added 3.6pp to GCAP's NAV TR, and its valuation now translates into an implied LTM multiple of 11.6x at end-December 2020 (vs 8.3x at end-September 2020). Operationally, the business was quite robust with a slight 4.3% y-o-y drop in premiums earned in FY20, mainly due to the impact of COVID-19 travel restrictions on the compulsory border third-party liability insurance (MTPL) line. This was partially offset by an increase in other business lines (eg commercial property and motor insurance). Net underwriting profit and net profit were down in FY20 by 1.8% and 7.2%, respectively, nevertheless translating into a healthy ROAE of 24.8% (vs 30.4% in FY19).

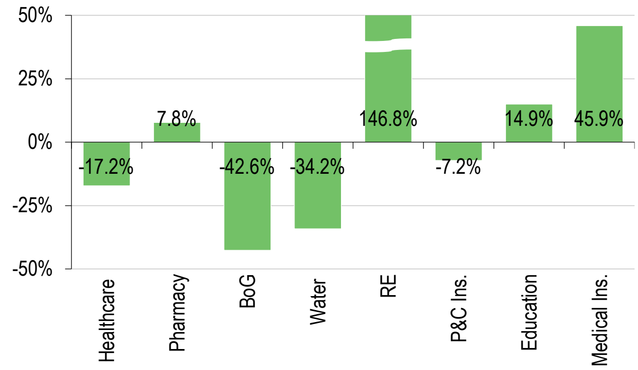
The medical insurance and investment stage companies (**renewable energy** and **education**) also contributed positively to Q4 NAV TR in terms of operating development.

Exhibit 4: GCAP's assets FY20 y-o-y revenue* change



Source: GCAP, BoG, Edison Investment Research. Note: Vertical axis scaled for readability. *Net interest income for BoG; net premiums earned for insurance businesses.

Exhibit 5: GCAP's assets FY20 y-o-y EBITDA* change



Source: GCAP, BoG, Edison Investment Research. Note: Vertical axis scaled for readability. *Net income for BoG and insurance businesses.

Retaining a comfortable liquidity position

GCAP continues to focus on investments in renewable energy and education (in line with its cash accumulation and preservation strategy introduced during the COVID-19 pandemic), having earmarked GEL167m or c US$50m over three to five years. This seems already secured by its current liquid position (c GEL173.1m or US$54m at end-2020) and issued loans (GEL109m or c US$33m at end-2020).

GCAP's management believes there are no major near-term liquidity needs across the portfolio as the aggregate cash balances of its holdings went up significantly in FY20 to GEL392m vs GEL183m in FY19. Nevertheless, it is worth flagging that GCAP's portfolio companies need to refinance GEL283.9m of debt in 2021. This includes GEL110.3m in the healthcare services and retail pharmacy businesses, which seem to have a strong liquidity profile. Based on a discussion with the management, we understand that a further GEL99m (US$30m) is secured by commercial real estate valued at c US$40m and GEL30m is related to GCAP's hospitality business where management is in negotiations with banks to restructure the loans and prolong payments until hotels again start generating cash flow.

GCAP received c GEL30m in dividends from private companies (water utility, P&C insurance and renewable energy) in FY20 (vs GEL122m in FY19 including GEL49m non-cash in-kind dividend), in line with management expectations communicated during the capital markets day in November 2020. GCAP also collected GEL40m from the repayment of a loan issued to renewable energy (repaid with proceeds from the Green Bond issued in July 2020). Furthermore, management reiterated the dividend income guidance of GEL60–70m for private companies in FY21. This should largely cover GCAP's ongoing cash operating expenses (GEL19.5m in FY20) and net interest expense (GEL41.5m in FY20).

Peer group comparison

In Exhibit 6, we show a group of private equity funds specialising in direct investments (including co-investments), which we consider peers for GCAP. The funds differ significantly in terms of geographical and industry exposure and none can act as a close peer to GCAP. Having said that, GCAP's one-year NAV performance is the second lowest in peer group in sterling terms, which partly stems from weak Georgian lari in 2020 (base currency performance is much closer to the peer average). While GCAP is the only fund in the group that is not paying dividends, we note that it has historically performed NAV accretive buybacks. GCAP trades at the highest discount in the group, which may be due to its exclusive exposure to the Georgian economy and lack for meaningful track record in terms of exits.

Exhibit 6: Listed private equity investment companies peer group at 26 February 2021* (in sterling terms)

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Georgia Capital	**223.7**	**(13.3)**	**N/A**	**N/A**	**(55.0)**	**1.9**	**No**	**124**	**0.0**
Wendel SE	3,740.8	(4.4)	(13.2)	37.8	(33.0)	1.0	No	107	2.9
HgCapital Trust	1,449.8	21.1	66.6	141.9	16.4	1.6	Yes	100	1.4
NB Private Equity Partners	542.4	7.4	27.7	80.8	(23.6)	2.2	Yes	118	4.0
Oakley Capital Investments	518.3	4.5	50.7	90.9	(28.8)	1.1	Yes	100	1.6
Princess Private Equity	677.0	12.1	39.3	103.6	(14.8)	1.8	Yes	100	4.5
Symphony International Holding	137.6	(36.1)	(39.5)	(31.1)	(42.6)	2.4	No	100	6.9
Peers average	**665.0**	**1.8**	**29.0**	**77.2**	**(18.7)**	**1.8**		**103**	**3.7**
Rank	**6**	**6**	**N/A**	**N/A**	**7**	**3**		**1**	**7**

Source: Morningstar, Refinitiv, Edison Investment Research. Note: TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. 100=ungeared. *12-month performance based on latest available ex-par NAV as at end-December (HgCapital Trust, Wendel SE and Symphony International Holding are as at end-September).

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