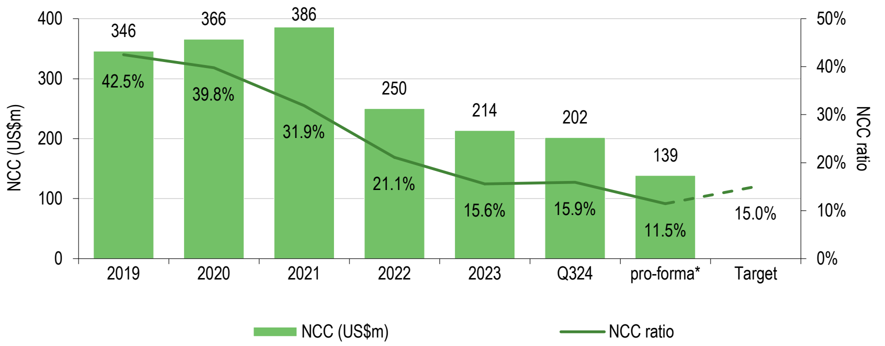
Georgia Capital

Successful disposal from the portfolio

Investment companies
Private equity

Georgia Capital's (GCAP's) net asset value (NAV) per share increased by 6.2% q-o-q in Q324 in Georgian lari terms (3.3% in sterling). The private portfolio companies performed well operationally, whereas the stock value of GCAP's holding in Bank of Georgia (BoG) remained flat quarter-on-quarter, after de-rating in Q224 amid political uncertainty. Meanwhile, international strategic investors seem to remain confident in Georgia's prospects, as highlighted by GCAP's strong uplift on the disposal of the beer and distribution business to Royal Swinkels, which added 1.8pp to its NAV performance. GCAP continues NAV-accretive buybacks (+2.4pp accretion in Q324) financed by record-high recurring dividends received from the portfolio. However, its shares continue to trade at a wide discount to reported NAV of 48.9% (narrowing slightly versus the one-year average of 54.6%).

GCAP has brought its holding level leverage to its target



Source: Georgia Capital, Edison Investment Research. Note: NCC, net capital commitment ratio (see our May 2022 note for methodology details). *Includes disposal proceeds received after the reporting date.

The Georgian economy remains strong

The Georgian economy is continuing its solid momentum, with September 2024 GDP growth of 8.3% y-o-y (9M24: 9.8%). The International Monetary Fund expects Georgia to maintain a robust growth rate in the medium term, forecasting 7.6% growth in 2024 (up from 5.7% previously), whereas local brokers Galt & Taggart and TBC Capital expect growth of 8.5% and 8.8%, respectively. Meanwhile, the European Council has stopped Georgia's accession process to the EU amid the political turmoil, but we note that the vast majority of the Georgian population is pro-European, putting pressure on the government to align its policies with EU values.

A quality play on the local economy

GCAP provides diversified exposure to Georgia, mostly through market-leading businesses in sectors such as healthcare, pharmacy, financials, renewable energy and education. GCAP shares may be appealing to investors who appreciate the underlying strength of the Georgian economy and the strong market position of GCAP's portfolio companies. The second major disposal from its portfolio underlines management's exit capabilities and confirms the interest of international strategic investors in opportunities arising in Georgia.

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4 December 2024

Price	**1,166p**
Market cap	**£461m**
NAV*	**£874m**
NAV per share*	2,282p
Discount to NAV	48.9%
Yield	0.0%
Ordinary shares outstanding*	38.3m**
Code/ISIN	CGEO/GB00BF4HYV08
Primary exchange	LSE Standard
AIC sector	N/A

52-week high/low	1,374p	837p
NAV high/low	2,648p	2,210p

*As at end-September 2024. **Excluding shares in management trust

Gearing

Net gearing at 30 September 2024	8.4%

Fund objective

Georgia Capital focuses on scalable private equity opportunities in Georgia. These opportunities have the potential to reach an equity value of at least GEL300m over the next three to five years and the company can monetise investments through exits as investments mature.

Bull points

- The majority of the portfolio is exposed to resilient and well-established businesses.
- Successful disposal of the beer and distribution business reinforces confidence in GCAP's exit capabilities and portfolio valuations.
- Regular dividend income from several portfolio companies.

Bear points

- Recent political developments result in higher investment risk in Georgia.
- High discount to NAV limits GCAP's activity in terms of new investments.
- GCAP has just started building its track record of investment realisations.

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Results driven by strong fundamentals

Successful exit of GCAP's beverage business…

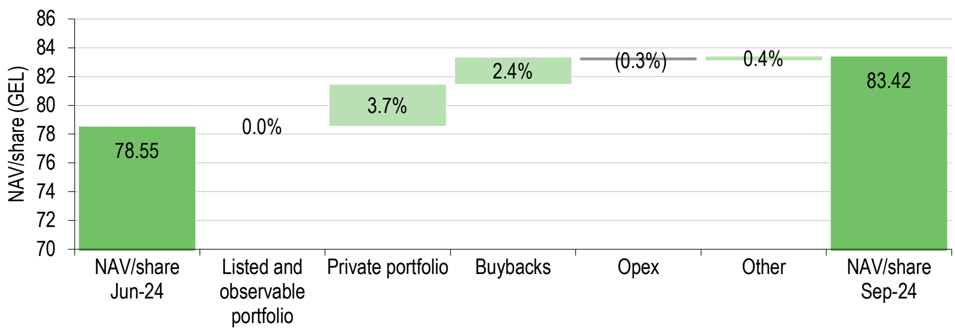
On 28 October, GCAP announced the disposal of its beer and distribution business to an international strategic investor, performed at a price well above the last carrying value. We believe this is a noteworthy occurrence for investors considering investment in GCAP shares from at least two perspectives. Firstly, GCAP's second major disposal (after the water utility business was sold in 2022) proves the effectiveness of its business strategy, as it gradually builds an exit track record. Secondly, the transaction confirms that despite political unrest (described below), quality assets attract international investors into Georgia. It is worth noting that the business has achieved an organic growth rate over the last three years of 29% pa in revenue, and 79% pa in EBITDA.

GCAP has sold 80% of its 92.4% stake in its beer and distribution business (the wine segment remains within the portfolio) for net cash proceeds of US$63m. The remaining 20% stake has a clear exit path, as it is subject to put and call options. GCAP can exercise its options over three years (2028–30), and thereafter Royal Swinkels can exercise its options over the subsequent three years (2031–33). The acquirer is a global beer, malt and soft drinks manufacturer headquartered in the Netherlands with €1.1bn annual turnover (2023). The transaction was performed at an uplift to the end-June 2024 book value (we calculate a solid c 30% uplift) and resulted in a 1.8% NAV/share accretion for GCAP in Q324.

… contributed to solid NAV increase in Q324

In Q324 GCAP's NAV/share increased by 6.2% in Georgian lari (GEL) terms (up 3.3% in sterling, due to depreciation of the GEL), which was supported by NAV-accretive buybacks (2.4pp) and uplift on the disposal of the beverages business (1.8pp). The revaluation of the private portfolio (excluding the impact of disposal) added further 1.9pp NAV accretion as the solid operating performance was partially offset by a contraction in valuation metrics. The performance of BoG's stock, which represented 33% of GCAP's portfolio at end-September 2024, was broadly flat over Q324 in total return terms but it is worth noting that, since end-September, the share price has rallied almost 30% in total return sterling terms (as at 4 December 2024). Over the longer term, GCAP's NAV performance is robust, as over the five years to end-September 2024 the company generated a 10.6% NAV return per year in sterling terms, compared to 5.7% delivered by the UK all-share index.

Exhibit 1: GCAP's NAV per share development in Q324



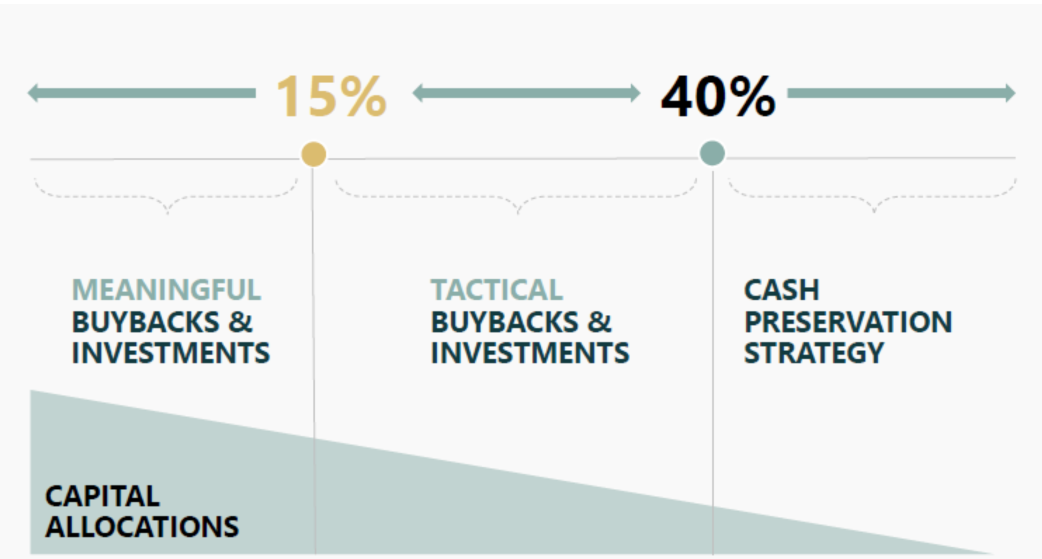
Source: GCAP

The portfolio generated a record-high level of dividends in Q324 at GEL141.6m, bringing the figure for the first nine months of 2024 (9M24) to GEL191.9m (including declared dividends). The recurring dividends amounted to GEL119.0m (9M24: GEL169.3m) and the company is comfortable with its target of GEL180m for 2024. The largest dividend payer remains BoG, contributing 75% of the total amount in cash dividends and share buybacks, including a one-off distribution of GEL22.6m. The one-off distribution represents GCAP's advanced participation in the BoG buyback programme, which temporarily reduced GCAP's stake in BoG to 19.1% (19.5% target).

GCAP has delivered to its target…

Strong distributions from its portfolio companies have supported GCAP's deleveraging, with the net capital commitment (NCC) ratio decreasing to 15.9% at end-September 2024 (from 18.9% at end-June 2024), close to its over-the-cycle target of 15%. We calculate that including the proceeds received from the disposal of the beverages business (US$63m) and dividends received after the reporting date (c US$16m) the NCC ratio stands at 10.3%, which may indicate scope for further significant share buybacks, as per GCAP's capital allocation policy. We note that GCAP's shares continue to trade at a wide discount to NAV (48.9%), thereby limiting the pool of potential new investments that are more attractive to shareholders than share buybacks.

Exhibit 2: GCAP's strategy – NCC ratio navigation tool



Source: GCAP

…and portfolio companies made good progress

At the portfolio companies' level, there was some progress in deleveraging, with the aggregate net debt to EBITDA ratio of the portfolio (private companies in large and investment-stage companies) reduced to 3.1x, from 3.3x at end-June 2024, and all of the private portfolio companies have reduced their net debt to EBITDA ratios in Q324 (see Exhibit 3). GCAP's hospitals business is furthest from its leverage target, with the ratio at 5.9x adjusted EBITDA, compared to its target of 2.5x. The operations of hospitals are still being affected by new regulations aimed at improving healthcare quality in Georgia introduced in 2023 (described in our previous note). Having said that, its cash generation has improved, with operating cash flow up 61% y-o-y in 9M24 (GEL23.1m) and EBITDA to cash conversion up 23.5pp (to 61%, on a broadly flat year-on-year EBITDA result).

Exhibit 3: Adjusted net debt to EBITDA ratios across GCAP's private portfolio			
	30-Sep-24	30-Jun-24	Target
Retail (pharmacy)*	2.2x	2.4x	Up to 1.5x
Insurance (P&C and Medical)	0.3x	0.7x	No leverage
Hospitals**	5.9x	6.2x	Up to 2.5x
Renewable energy	5.7x	5.8x	Up to 6.0x
Education	1.2x	0.9x	Up to 2.5x
Clinics and diagnostics***	2.8x	2.7x	Up to 2.5x

Source: GCAP. Note: *Adjusted for the minority buyout agreement. **Excluding the impact of the disposal of a regional hospital in Q423. ***Excluding the impact of the disposal of a building in Q323.

The aggregate EBITDA of the private portfolio was up 17% y-o-y in Q324

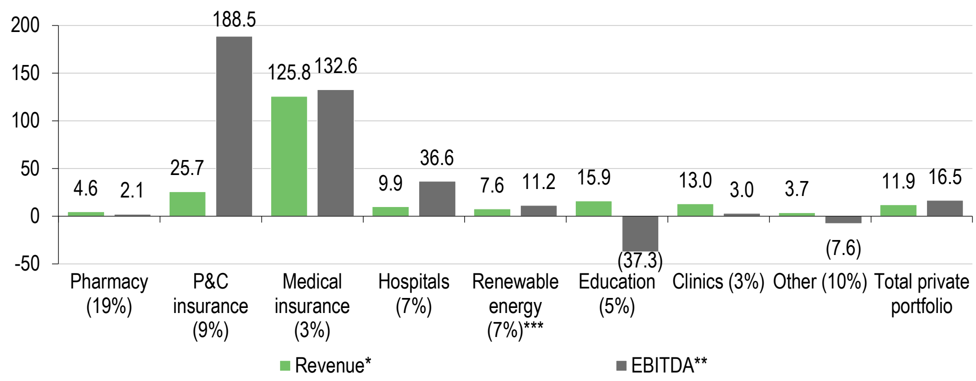
The companies in GCAP's portfolio performed well operationally, with aggregate portfolio revenue increasing by 11.9% y-o-y in Q324 and EBITDA by 16.5% (9M24: 8.9% and 15.3% y-o-y, respectively). At the same time their operating cash flows were twice as high in 9M24 compared to 9M23 (GEL215m).

The largest contributor to growth was the **insurance** business, with the top-line in P&C insurance business growing on strong motor, agricultural and credit life insurance lines, and the medical division being supported by the acquisition of Ardi's insurance portfolio in April 2024 (on top of a c 10% increase in medical insurance policy prices). The increase in pre-tax profit was aided by the consolidation effect (medical) and lack of one-off effects reflected in Q323 results (P&C).

The **pharmacy** business remains GCAP's largest private portfolio holding (representing 19% of the total portfolio), and continues strong expansion, with its chain reaching 434 pharmacies and franchise stores in Georgia, Armenia and Azerbaijan as at end-September 2024 (up 27 y-o-y). The same store revenues decreased by 2.0% y-o-y, affected by price regulations (maximum selling price for both prescription and non-prescription medicines), which was more than offset by the chain growth. The pressure on EBITDA margin from expansion costs is actively addressed by promoting sales of higher-margin para-pharmacy products (39.6% of revenues in Q324, flat share year-on-year).

It is also worth noting good operational improvement at the **hospitals** business, which recorded 10% y-o-y growth in revenues and 37% in EBITDA, despite the divestment of one hospital in Q423. The business is rebounding to normal operational levels following mandatory regulatory renovations and is increasing the share of revenues from its high-margin outpatient services (up 2.7pp y-o-y to 36.2% of total revenues), following the expansion of the range of offerings.

Exhibit 4: GCAP's private portfolio companies' operational results (Q324 y-o-y % change)



Source: GCAP, BoG, Edison Investment Research. Note: Share of portfolio value indicated on X-axis labels. *Net revenue for pharmacy, hospitals and clinics. **EBITDA excludes IFRS 16 effect for pharmacy, hospitals and clinics; pre-tax profit for P&C insurance and medical insurance. ***Change in operating currency (US$) terms.

The value of GCAP's stake in LSE-listed Bank of Georgia remained broadly flat in Q324. The bank reported strong Q324 results, with return on average equity of 32.1% (up from 31.3% in Q224, and compared to its target of at least 20%), and net interest margin of 6.2% (Q224: 6.3%). The bank successfully integrated the acquired Ameriabank with no visible dent in profitability.

Exhibit 5: GCAP's portfolio companies' valuation changes

	Share in portfolio at end-September 2024	Value creation in Q324 (%)	Value creation in Q324 (GELm)	of which operating performance (GELm)	of which multiple change and FX (GELm)
BoG	33%	(0.4%)	(4.5)	N/A	N/A
Pharmacy	19%	5.8%	38.5	37.0	1.5
P&C insurance	9%	6.9%	21.5	79.9	(58.4)
Hospitals	7%	0.8%	1.9	47.9	(46.1)
Renewable energy	7%	1.9%	4.5	21.9	(17.5)
Education	5%	(6.9%)	(12.5)	(16.0)	3.5
Water utility	5%	3.1%	5.0	N/A	N/A
Clinics and diagnostics	3%	(3.2%)	(3.3)	4.0	(7.4)
Medical insurance	3%	1.2%	1.1	5.1	(3.9)
Other	9%	19.2%	62.9*	53.9*	9.0*
Total portfolio	**100%**	**3.3%**	**115.1**	**233.7**	**(119.2)**

Source: GCAP, Edison Investment Research. Note: *Includes uplift on disposal of beer and distribution business.

The Georgian Dream has been re-elected

In the October's parliamentary elections, the ruling party Georgian Dream secured a decisive win, with 54% of the votes, allowing it to single-handedly set up a government. The results were not without controversy, as several international observers highlighted election violations, and watchdogs are questioning the results; for example, US-based Edison Research, which carried out exit polls for opposition TV channels, said the final figure could not be explained 'by normal variation'. The ruling president accused the party of voter fraud, and civilian protests continue to this day (as of 4 December 2024). Georgia's presidential elections are scheduled for January, which will mark the first elections in the electoral college system.

Current protests follow the longer political turmoil, started earlier this year with the introduction of the 'foreign agents act', which eventually prompted the European Council to stop the EU accession process for Georgia on 17 October 2024. While we recognise that political turmoil could negatively affect the international perception of Georgia, and in turn limit its ability to attract foreign capital, we need to point out that so far there is limited evidence of that, as highlighted by GCAP's successful recent disposal. Additionally, the Georgian population is overwhelmingly pro-European and the Georgian economy is closely tied to the Western bloc, so one can expect some alignment of Georgian policies with EU values. Meanwhile, on 28 November 2024, the European Parliament voted to reject the results of the recent elections, which was met with Georgian Dream's declaration of postponing any negotiations on EU accession until 2028.

GCAP continues NAV-accretive buybacks

GCAP distributes capital to investors through regular share buybacks. So far this year (up to 4 December 2024), GCAP has acquired 3.7m shares from the market, including tax-regulated statutory buybacks for the management trust. It has distributed GEL132.9m in the form of repurchases, which represents 3.9% of NAV and 8.8% of the market capitalisation at end-December 2023. We calculate that GCAP is nearing the conclusion of its current US$40m buyback programme but given that GCAP shares still trade at a wide discount to NAV, we expect the announcement of yet another programme in the coming months. GCAP currently trades at a 48.9% discount to its end-September NAV (see Exhibit 6) and, taking into account the strong performance of BoG shares, after the reporting date its discount to live NAV estimate currently stands at 53.2%.

Exhibit 6: GCAP's discount to NAV* over five years (%)

Source: GCAP, LSEG Data & Analytics. Note: *Last reported quarterly NAV.

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