Georgia| Research
Financials | Banks
Initiating Coverage

Bank of Georgia

In a Class of its Own

February 14, 2012

Olena Zuikova | olz@concorde.com.ua | +380 44 391 5577
Vitaliy Vavryshchuk | vv@concorde.com.ua| +380 44 391 5577

Contents

Cover photo: Bank of Georgia headquarters

INVESTMENT SUMMARY

We initiate coverage of Bank of Georgia (BGEO LI), the country's largest lender and only foreign-listed equity, with a 12M target price of USD 24.1/share, implying upside of 84%, and a BUY rating. The bank is a classic growth story, with assets seen expanding at a 5Y CAGR of 16% and net income growing even faster at 21% on improving efficiency. Thanks to its narrow focus on the rapidly growing Georgian market and proven strategy, the bank boosted profitability in recent years and still has ample room for more. The lender, like Georgia's economy as a whole, has proved resilient to external shocks, including the global financial crisis and a 2008 military conflict with Russia, and now stands out among peers in terms of growth.

Comfortable growth in line with underpenetrated Georgian banking sector

Bank of Georgia is set to take advantage of the fast growth of the Georgian banking sector, which still remains strongly underpenetrated (end-2011 loans-to-GDP was 30% in Georgia vs. the 55% average in CEE). We expect sector assets to grow at a 5Y CAGR of 16%, one of the fastest rates in CEE. With a 36% market share by assets, Bank of Georgia is comfortably positioned and expects to grow broadly in line with the sector.

Asset quality sound, funding well balanced

Bank of Georgia's loan quality is solid: NPLs are below 4% of gross loans and are fully provisioned. Funding is fairly balanced: deposits and wholesale loans account for 2/3 and 1/4 of liabilities, which we think offers an optimal mix in terms of cost and maturity/stability.

Superior profitability, but still below potential

ROE recovered swiftly from 12% in 2010 to 18% in 2011E against fast loan book growth, tough cost control and slashed provisioning charges. We see ROE staying close to 18% in 2012E and note that attaining management's 20%+ ROE target will depend largely on the bank's ability to boost leverage.

Establishing a regular dividend payout policy

We think one of the bank's likely options to improve its assets-to-equity ratio and lift ROE is to establish a regular dividend policy. Bank of Georgia paid 11% of its 2010 net income in dividends and we think the rate could increase to up to 15% with respect to 2011 net income and further to 40% by 2015.

LSE premium listing yet another sweetener

Liquidity in the stock should improve considerably in the coming months: the bank is seeking a premium listing on the LSE via newly-established UK-based Bank of Georgia Holding (BGH) and inclusion in a FTSE All-Share Index.

Broadly healthy macro and banking sector

Georgia's economic growth remains robust with 4Q11 GDP increase estimated at 8.1% yoy. The country successfully addresses its hefty C/A deficit by attracting sufficient FDI and debts and its national currency appreciated 7% vs. the US dollar since the start of 2011. Banks are quickly expanding their deposit bases and loan portfolios (+31% and +28% in 2011, net of FX effects) while maintaining decent capital buffers.

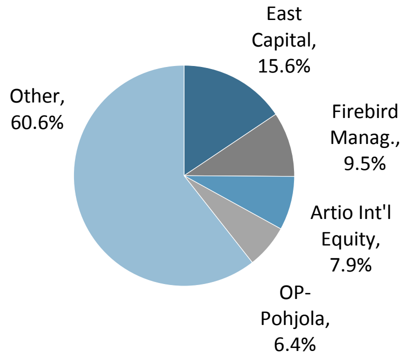
SHARE AND BANK DATA

Market data*

Ticker	BGEO LI
Current price / share	USD 13.1
Shares outstanding	32.88 mln
Shares per DR	1
MCap., USD mln	430
Free float, %	95%
Free float, USD mln	409

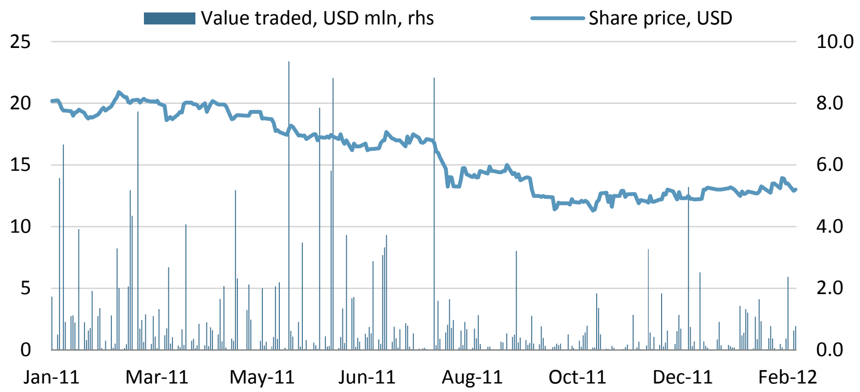
** Data as of Feb. 13, 2012*
Source: Bloomberg, Company data

Shareholder structure*



** Data as of Sept. 30, 2011. Only beneficiaries of 5% or larger stakes indicated*
Source: Company data

Share price performance and daily trading volumes



Source: Bloomberg

Key financials (USD mln) and ratios

	2010	2011E	2012E
Net interest income	121	139	158
yoy	6%	15%	14%
Net income	46	81	97
yoy	nm	75%	20%
Net loans	1,327	1,585	1,864
yoy	35%	20%	18%
Assets	2,259	2,815	3,331
yoy	31%	25%	18%
Deposits	1,131	1,478	1,798
yoy	50%	31%	22%
ROE	12.4%	18.0%	17.2%
ROA	2.3%	3.2%	3.2%

Source: Company data, Concorde Capital

Consensus projections, 2012E

	Consensus	Concorde Capital
Net income	USD 86 mln	USD 97 mln
ROE	16.9%	17.2%
ROA	2.9%	3.2%

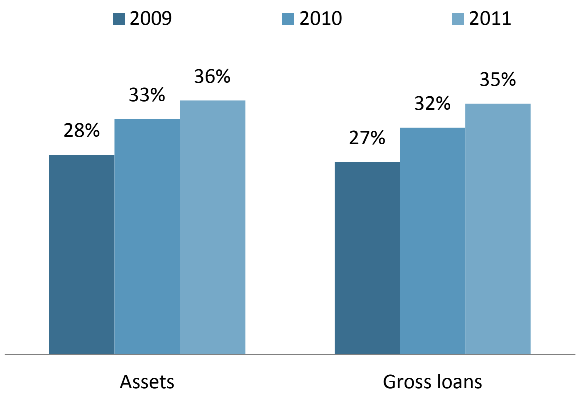
Source: Bloomberg, Concorde Capital

THE BANK IN A NUTSHELL

Bank of Georgia is Georgia's largest bank, accounting for 36% of total banking sector assets and 35% of gross loans. The bank's shareholder structure is fairly diversified, with the largest shareholder owning a 15.6% stake.

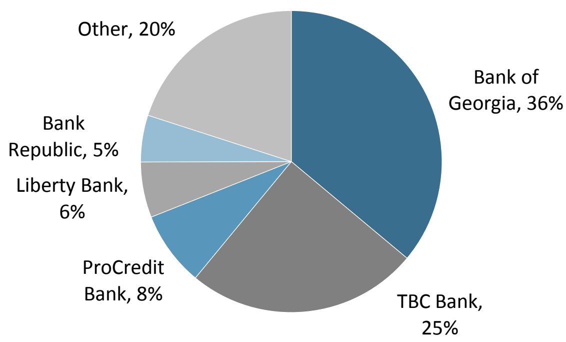
The bank has credit ratings from all the major agencies (S&P: BB-/B, Fitch: BB-/B, Moody's: B1/NP, FC). BGEO LI is Georgia's only equity, listed on the LSE's main board (via GDRs).

Bank of Georgia's market shares



Source: NBG

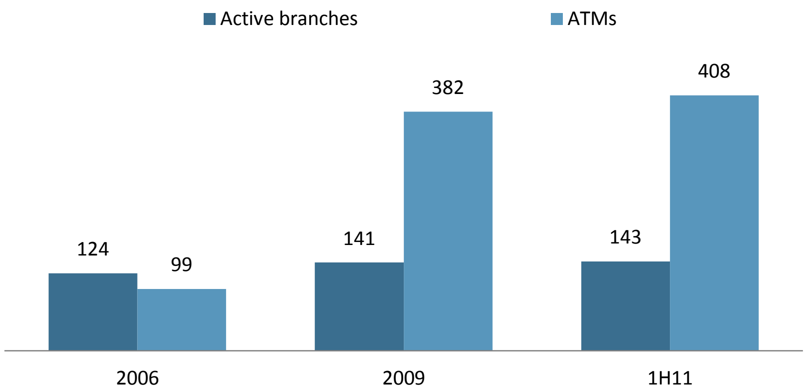
Georgia's largest banks by assets, end-2011



Source: NBG, Concorde Capital

In a country of 4.4 million people, the bank has more than one million retail accounts and about 100,000 corporate accounts. It also boasts 143 retail outlets and 408 ATMs.

Active branches and ATMs



Source: Company data

Having revised its strategic focus, the bank has become a pure Georgian play. Bank of Georgia's overseas businesses are limited to Belarusky Narodny Bank (BNB) in Belarus (where it holds 80%) and exposure to BG Bank in Ukraine. The Belarusian subsidiary will be treated as a non-core asset and its business model will focus solely on maximizing ROE. Bank of Georgia sold an 80% stake in BG Bank in 1Q11, and plans to divest its remaining 19.4% stake in the future.

EN ROUTE TO LSE PREMIUM LISTING

In December 2011, newly established UK-based Bank of Georgia Holding (BGH) offered holders of existing Bank of Georgia (BoG) GDRs and local shares to exchange those securities for ordinary shares in BGH on a one-for-one basis. As a result of the offer, the bank will become a subsidiary of BGH. The holding intends to seek a premium listing on the LSE and inclusion in FTSE Index. The exchange offer is valid until February 21, 2012.

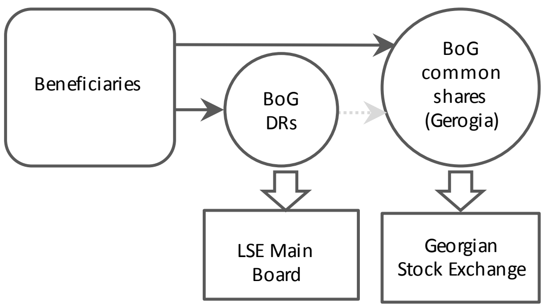
Management believes this kind of legal restructuring will:

- enable the group to strengthen and broaden its investor base
- improve the liquidity of its securities, the profile of the group and its exposure to the investor community
- show their commitment to strong corporate governance

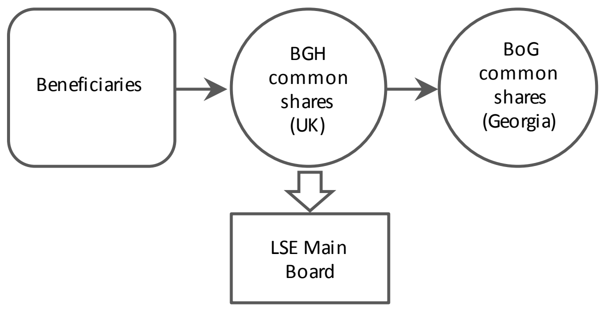
After listing, BGH will be subject to tougher reporting and compliance obligations than those the group is currently subject to.

In December, the Bank of Georgia said the EBRD and IFC agreed to convert a portion of their subordinated loans (USD 25 mln each) to the bank into BGH shares. Following the deal, each institution will hold a 5% stake in the group. We account for 3.64 million of additional shares to be issued (11% of the current number outstanding) in our valuation.

Before restructuring



Post-restructuring



Source: Company data, Concorde Capital

SWOT

Strengths

- Established leader (36% market share by assets) in a highly concentrated banking sector
- Strong deposit and loan pricing power due to its high market share
- Strict cost control (long-term sustainable C/I projected at 45%)
- High asset quality – delinquent loans are adequately provisioned
- Strong corporate governance standards, 4-year history on the LSE

Weaknesses

- High asset dollarization ratio (FX loans make up 72% of total book). Penalized through high capital requirements (National Bank of Georgia applies 175% risk weighting to FX assets)
- Limited room for above-sector growth given its high market share
- Overcapitalized, leverage below potential, meaning ROE is also below potential

Opportunities

- Sector remains underpenetrated by western standards (loans-to-GDP at just 30% in 2011E)
- Rapidly growing economy (2011 real GDP +6.8% yoy), driven by recovery in domestic demand, implies high growth potential for the financial sector
- Healthy local banking sector with no bankruptcies during 2008/09 – businesses and households are inclined to increase savings with banks, strengthening local funding bases
- Good loan servicing discipline among households and companies, which helped rapidly improve post-crisis loan quality, and brings with it the potential for a write-back of provisioned loans

Threats

- High asset dollarization ratio for the banking sector while household revenues are mainly GEL-denominated
- Political risks (the nearest parliamentary election is in October 2012, but the authorities approval rating remains high)
- Competitors are making up ground in expertise and broadly replicating Bank of Georgia's corporate management and customer care strategies

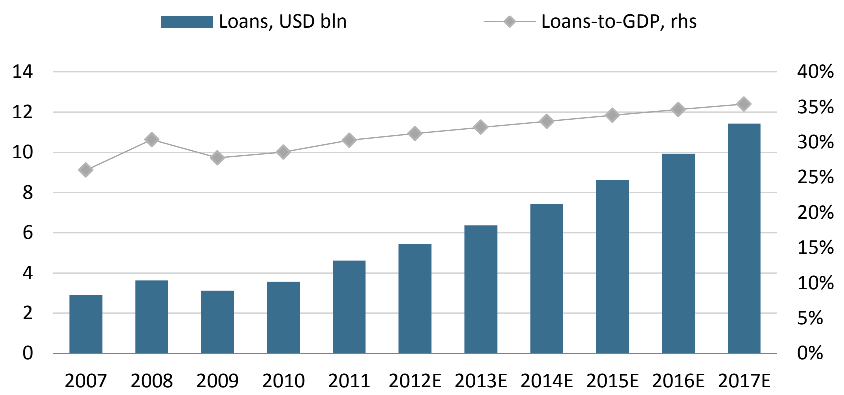
ASSETS: GROWING WITH THE SECTOR

Management has indicated it is comfortable with the bank's current market share (36% by assets at end-2011) and sees mid-term growth broadly in line with the sector. We note that keeping pace with the sector is still not a trivial task as key competitors are aiming to gain ground, a push that often comes against weaker loan underwriting standards. In either case, going with the tide is a more comfortable strategy for a mature bank than running ahead of competitors.

Maintaining growth in line with the sector is still a big deal in Georgia for two reasons:

- The loan penetration rate stands at just 30% of 2011E GDP, the lowest in the CEE. This low base can offer rapid growth opportunities.
- Georgia's GDP growth is among highest in CEE: 13% nominal CAGR in 2006-11E (~6% in real terms). If banks simply keep pace with our projections for GDP growth, the aggregate sector balance sheet would double in less than five years.

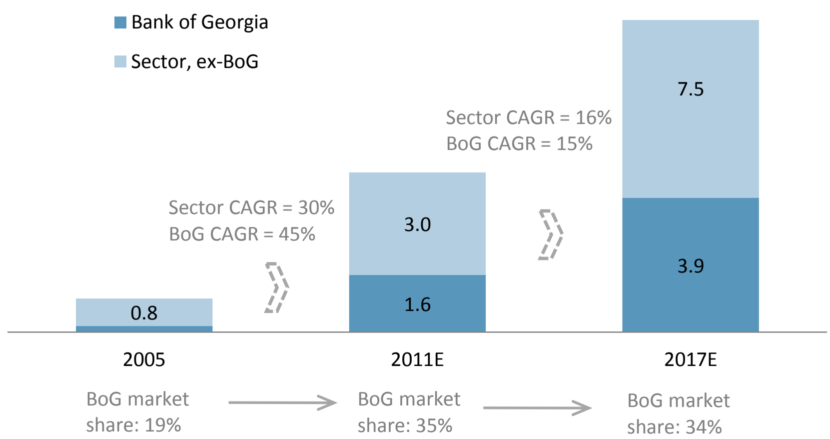
Bank lending in Georgia



Source: NBG, GeoStat, Concorde Capital

In line with management guidance, we expect Bank of Georgia's market share to slip by 1-2 pp in the next couple of years. Quite conservatively, we see loan penetration increasing to 36% over six years. Incorporating our nominal GDP forecasts, this translates into a sector CAGR of 16% for 2012-17 and 15% for Bank of Georgia.

Banking sector gross loan book, USD bln*

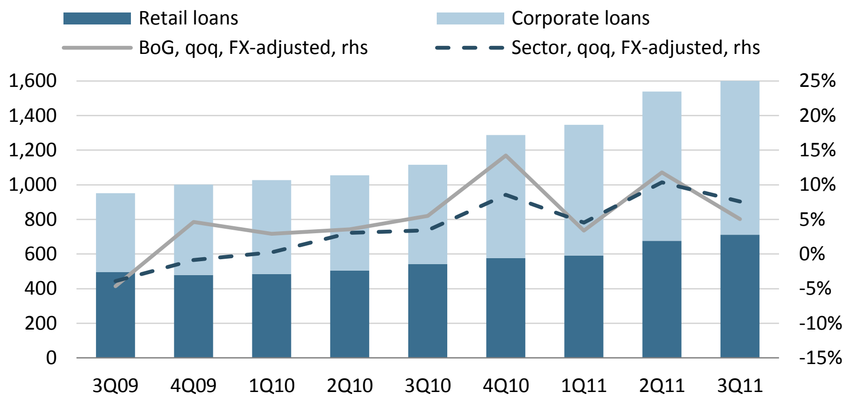


** Standalone loan book for BoG*
Source: NBG, GeoStat, Concorde Capital

Lending to remain strong in 2012

Bank of Georgia's loan growth was outperforming the sector until 4Q10, and since then its pace converged to that of the sector through 2011. We estimate the bank's net loan book increased 20% yoy last year and think the growth will decelerate only slightly (to 18% yoy) in 2012. Strong deposit inflow (projected at +22% this year) and the availability of external financing (mainly to rollover maturing debt) will support growth in the loan book.

Bank of Georgia's loan book, USD mln*



Standalone loan book
Source: Company data, NBG, Concorde Capital

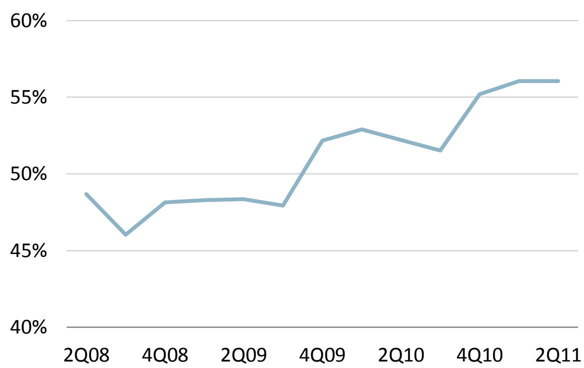
Loan focus shifts to corporates

In what has become a pattern for regional banks, corporate facilities are leading the lending recovery at Bank of Georgia. Corporate loans now make up close to 56% of the bank's total book, up from an average of 49% in 2009. We identify two major underlying reasons for the rebalancing:

- Retail clients are reluctant to resume borrowing, discouraged after being saddled with high leverage during the 2008-09 crisis. Many individuals prefer early loan repayment once their incomes allow. Demand for sizeable long-term loans is low but stronger for smaller short-term facilities.
- Strong economic growth, which feeds into higher CapEx and working capital needs, leaves the corporate sector hungry for debt.

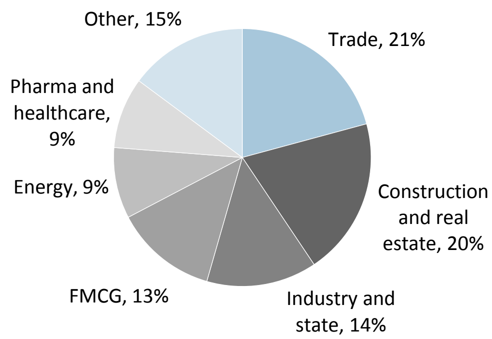
We expect lending to corporates to outpace retail again this year.

Corporate loans in Bank of Georgia's loan portfolio*



** Standalone loan book*
Source: Company data, Concorde Capital

Corporate loans by sector, end-1H11*



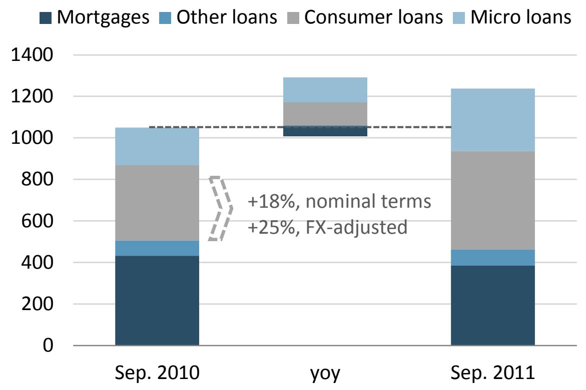
Standalone loan book
Source: Company data

Retail preference for smaller, shorter loans

Households' appetite for large long-terms loans expectedly faded in the aftermath of the 2008-09 crisis and consumer preferences have shifted to smaller and shorter duration loans. Total 2Q11 mortgage originations stood at less than half of pre-crisis levels (2Q08) and virtually flat yoy.

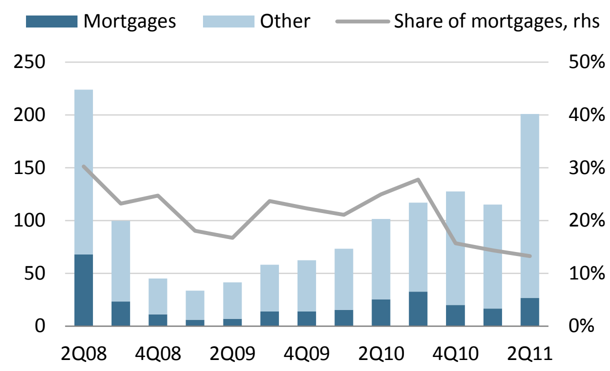
Against this backdrop, Bank of Georgia moved to satisfy customers' new preferences with a focus on consumer and micro loans. The strategy worked as Bank of Georgia's total retail book grew 18% yoy (+25% on an FX-adjusted basis) through 3Q11. The rebalancing of the loan portfolio is positive for the bank's margins: consumer and micro loans obviously carry higher yields than long-term mortgages.

Retail loan book, GEL mln



Source: Company data, Concorde Capital

Retail loans originated, USD mln

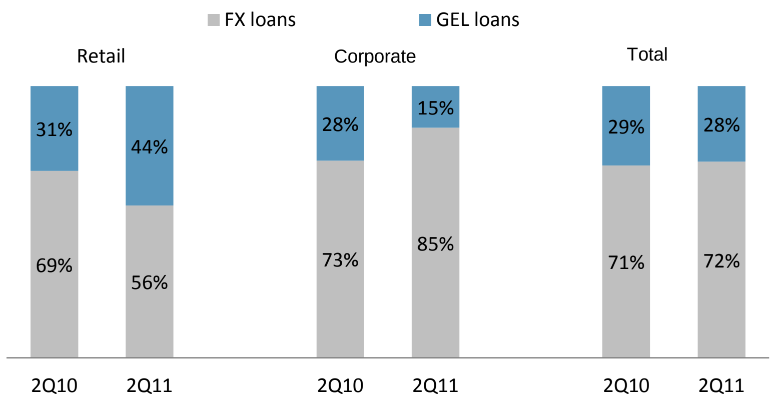


Source: Company data

Currency structure: positive underlying trend

In line with the rest of the domestic sector, Bank of Georgia's balance sheet is highly dollarized: the end-2Q11 share of FX loans was 72% (flat yoy). The broad balance sheet picture, however, masks a positive underlying trend: GEL loans are increasingly replacing FX facilities in the retail segment. On the corporate side, the opposite is true. The overall trend is positive in our view as companies are usually better-hedged against FX volatility than individuals (trade and the export-oriented industrial sector are among the top-3 borrowers).

Currency structure of Bank of Georgia's loan book

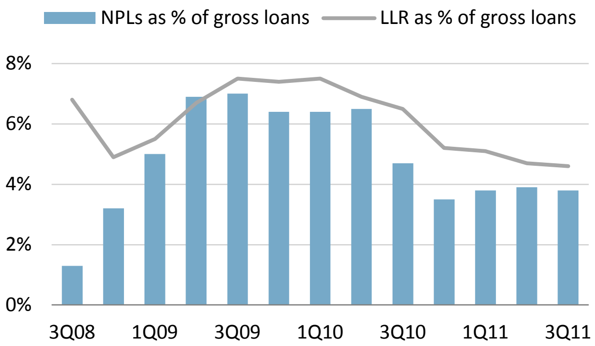


Source: Company data

HIGH LOAN QUALITY

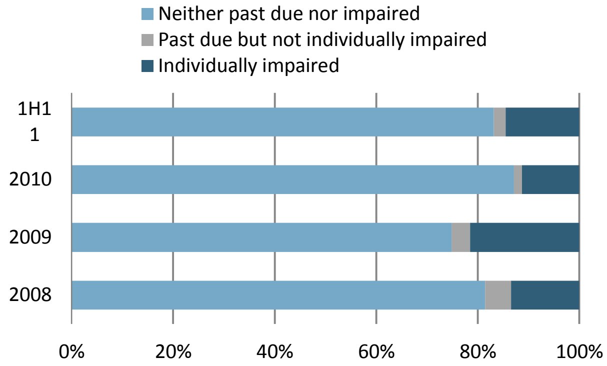
Georgia's robust economic growth brought relief to the bank in terms of loan quality: NPLs (loans overdue by 90 days or more) peaked at 6.9% at end-2Q09 but accounted for just 3.8% of total loans as of end-3Q11.

NPLs* and loan loss reserves (LLR)



[*] Loans overdue by 90 days or more
Source: Company data, Concorde Capital

Loan book quality, IFRS accounts

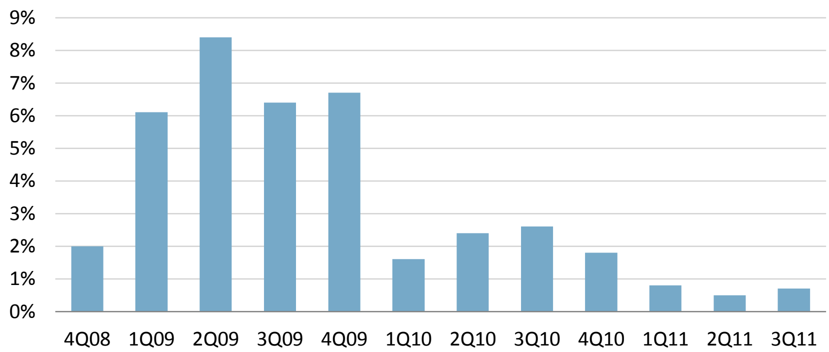


Source: Company data, Concorde Capital

Georgia was one of the least affected countries in the EM space by the global economic crisis in 2008-09: GDP contracted by a mere 3.9% in 2009 and the GEL/USD exchange rate weakened at most by 14%. Economic growth rebounded to 5.9% in 2010 and 6.8% yoy in 2011. Retail loans remained well-serviced thanks to FX remittances (on average 7-8% of GDP over 2005-10). The bank's strong loan enforcement power (due to liberal legislation) was also supportive of superior loan servicing discipline during the crisis.

Bank of Georgia's NPLs remained more than 100% provisioned at almost all times and the NPL coverage ratio is now over 120%. With asset quality concerns easing, the bank slashed its cost of risk from over 5% in 2009 to about 2% in 2010 and further to below an estimated 1% last year. We see NPLs continuing to shrink while the cost of risk should stay below 1% in 2012.

Cost of risk*



[*] Loan impairment charges (annualized) to interest earning assets
Source: Company data

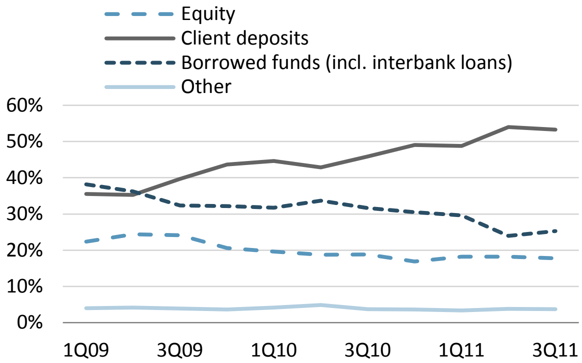
"DEPOSIT-FUNDED LENDING MACHINE"

Wholesale loans have traditionally made up a considerable portion of Bank of Georgia's funding base: to keep up with surging loan demand before the 2008-09 crisis, the bank was forced to raise funding externally. During that time, the ease of access to global credit markets largely shaped the bank's funding strategy. As of end-2008, deposits and wholesale loans held roughly equal shares of total funding at 36-38%.

With lending lagging deposits in growth in the aftermath of the 2008-09 crisis, the need for external loans has become less acute. The bank continues to attract wholesale loans on a case-by-case basis, taking advantage of cheap facilities. In 4Q11, Bank of Georgia secured a five year GEL-denominated agricultural finance facility (equivalent of USD 14.5 mln) and a USD 40 mln SME financing facility from EU-based institutions. By end-3Q11, the share of wholesale funding shrank to 25% and we project the trend to continue in the mid-term.

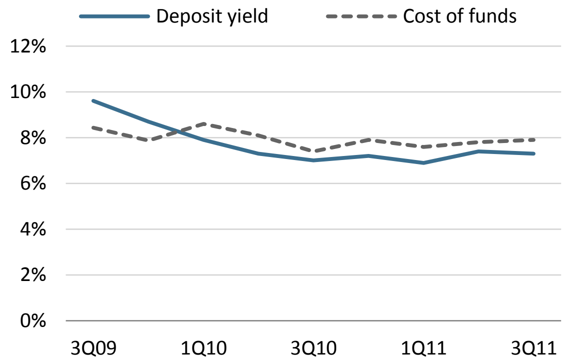
The bank's CEO has made it clear he wants to turn the bank into a "deposit-funded lending machine". Given that the cost of local deposit funding is declining, the switch to local deposits looks like a sound strategy, in our view. The bank's deposit rate has been below the cost of funding for almost 2 years.

Share of funding sources



Source: Company data, Concorde Capital

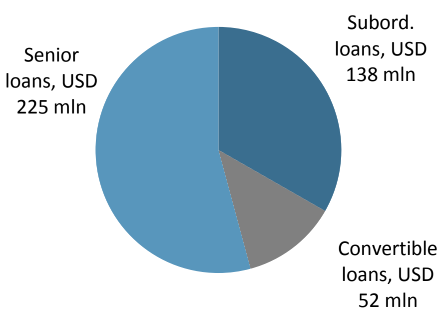
Deposit yield vs. cost of funds



Source: Company data, Concorde Capital

The maturity structure of bank's external wholesale funding is benign: according to the end-9M11 schedule, the bank is due to repay about USD 38 mln in 2012 (excluding Eurobond fully redeemed on Feb. 8) or 1.3% of equity and liabilities, and USD 42 mln in 2013 (1.9% of equity and liabilities). We expect the bank will refinance a larger portion of the maturing facilities.

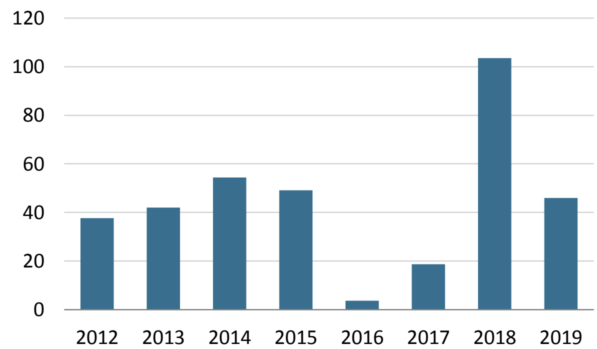
Structure of wholesale funding, end-9M11*



** Excludes Eurobond fully redeemed on Feb. 8, 2012*

Source: Company data, Concorde Capital

Maturity of wholesale funding, USD mln*



**Excludes Eurobond fully redeemed on Feb. 8, 2012; excludes USD 33 mln in funding whose maturity is not indicated in IFRS accounts*
Source: Company data, Concorde Capital

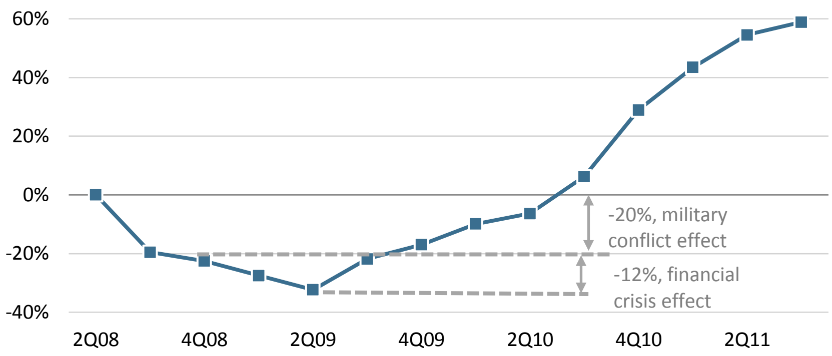
Deposits reasonably resilient to market shocks

In light of the growing reliance on funding through deposits, the key question becomes the stability of the deposit base and its resilience to political and economic shocks. A straightforward measure of the ability of the bank's funding base to withstand pressure is to take a look at Bank of Georgia's funding in 2H08-1H09, when the economy was involved in a military conflict and then the global financial crisis.

Bank of Georgia's funding base was dealt a major blow in August 2008 when households rushed to withdraw deposits as a military conflict with Russia escalated. In 3Q08, the bank's deposit base shrank 20% qoq (net of FX effects). As the global financial crisis deepened, the bank lost another 12% of end-1H09 deposits, implying a combined 32% peak-to-trough drop. The decline came against no government deposit guarantees and no freeze in deposit withdrawals. Bank of Georgia's deposit base fully recovered to pre-crisis and pre-conflict levels in just five quarters.

With the risk of a new military conflict being minor now, we model a worst-case scenario of a 10-15% deposit outflow. A stress test suggests an outflow of that size could be easily counterbalanced using free cash, via a halt in new lending, and fresh external funding, as was the case in 2008-09.

Deposit base change vs. end- 2Q08*

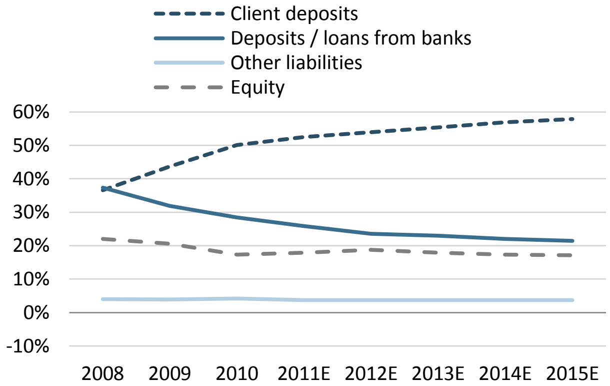


**Net of FX effects*
Source: Company data, Concorde Capital

Deposits seen at 60% of total long-term funding

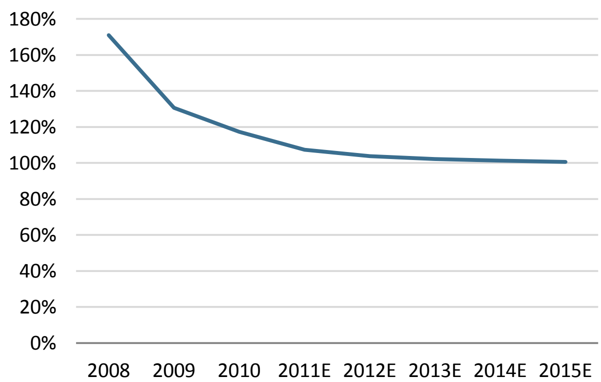
Looking forward, we see the share of deposits reaching 60% of Bank of Georgia's total funding, with wholesale facilities shrinking to 20% (virtually on par with equity). Accordingly, we forecast the long-term net loans-to-deposits ratio at close to 100%.

Funding structure projection



Source: Company data, Concorde Capital

Net loan-to-deposit ratio



Source: Company data, Concorde Capital

MARGINS TO NARROW SLIGHTLY ON COMPETITION

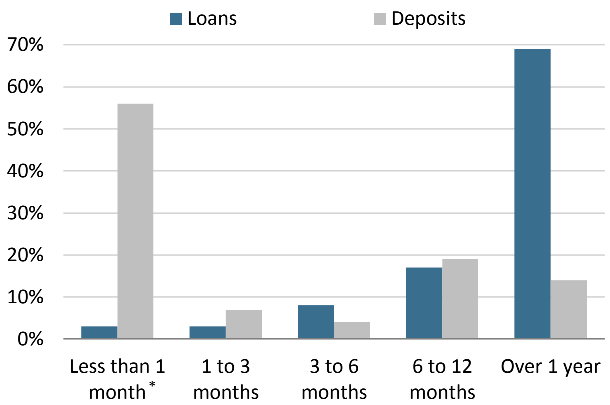
A cycle of monetary tightening by the National Bank of Georgia through 1H11 drove Bank of Georgia's cost of funds higher. The bank paid 7.9% on its interest-bearing liabilities in 3Q11, up from 6.8% in 3Q10. Meanwhile, bank lending rates declined due to growing competition with other lenders for new borrowers. Average interest on interest-earning assets edged down 0.3 pp yoy to 15.6% in 3Q11.

With inflation easing to just 2.0% yoy at end-2011 from the 2011 intra-year high of 14.3%, NBG softened its monetary stance and we expect interest rates to decline gradually through 2012, somewhat easing cost of funds pressure on the bank.

Market trends aside, we see the bank's loan yields and margins being shaped by several processes:

- The shift of the loan book toward lower-yield corporate loans (vs. higher-yielding retail), implying downward pressure on margins.
- Retail loans becoming increasingly dominated by short-term consumer and micro loans, a less stable but more lucrative source of interest revenues.
- Margins should be supported by the term structure of the bank's assets and liabilities. The bulk of deposits are short-term, which is an important advantage in an environment of declining interest rates, and which implies that the bank is fully capable of repricing most deposits within several months. Loans, on the other hand, still have a high share of long-term facilities (i.e. mortgages), with many still yielding rates fixed at peak levels before 2009.

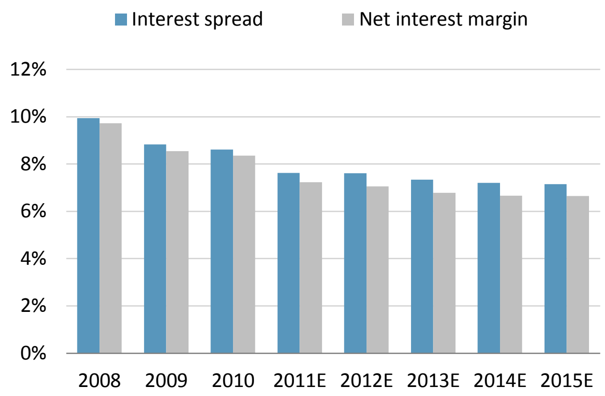
Maturity structure of loans and deposits, end-1H11



** includes demand deposits*

Source: Company data

Net interest margin



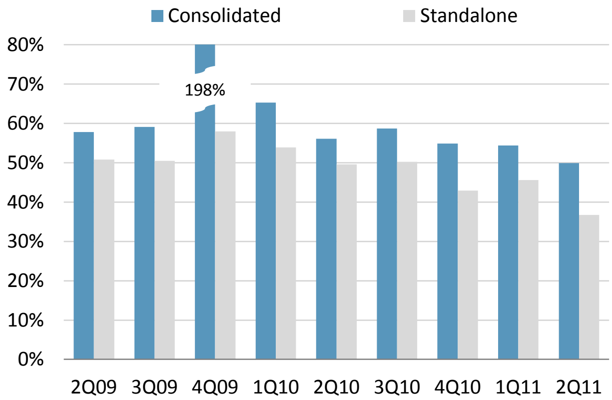
Source: Company data, Concorde Capital

We see building competitive pressures squeezing the bank's NIM from 7.2% in 2011E to 6.7% in the mid-term.

COST EFFICIENT, BUT MORE TO COME

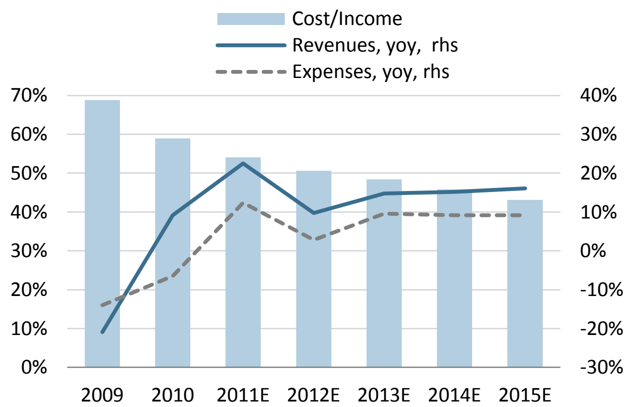
Bank of Georgia's consolidated cost/income (C/I) ratio improved to 54% in 2011E after hitting 93% in 2010 on a one-off expense due to a write-off of goodwill related to its Ukrainian subsidiary (69% excluding the effect of the goodwill write-off). With superior standalone cost control, consolidated C/I was affected by the poor efficiency of the Ukrainian business. Following the Ukrainian unit's disposal and against a continued build-up of the loan book, we expect the bank's consolidated C/I ratio will continue improving to reach 50% in 2012.

Cost/Income, consolidated vs. standalone



Source: Company data, Concorde Capital

Cost/Income (consolidated) vs. revenue/expense growth

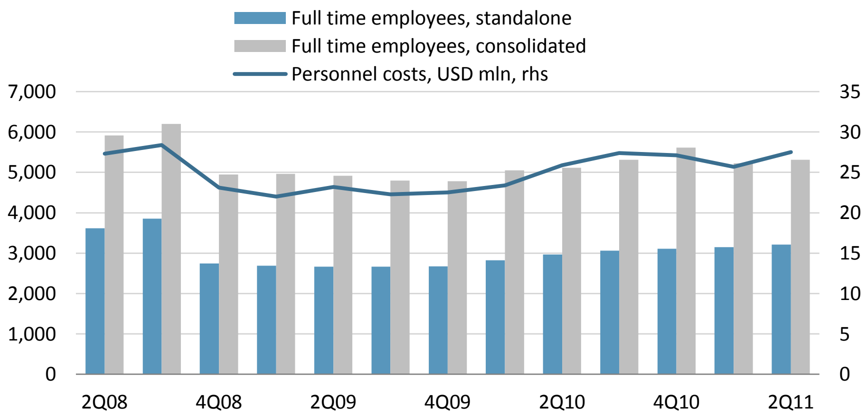


Source: Company data, Concorde Capital

Bank of Georgia runs a mature business, meaning that further growth in branches and personnel will be moderate. With limited need for further expansion, we expect the lender's operating expenses to be driven mainly by inflation. However, stiffer competition for qualified personnel will likely force the bank to increase salaries faster than the market average. We conservatively assume operating costs will grow 3-4 pp above annual inflation while noting that risks to our projection are definitely to the downside.

Looking into the mid-term, we see revenue growth outpacing expense growth by about 5 pp each year, with Bank of Georgia's consolidated C/I ratio coming down to a sustainable 45%.

Personnel

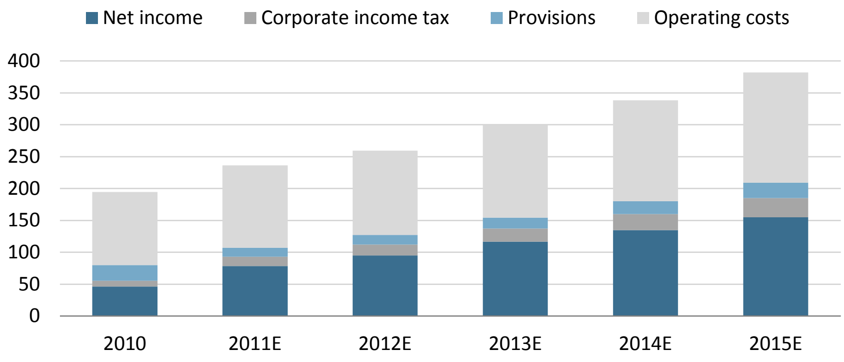


Source: Company data

PROFITABILITY: LEVERAGE IS KEY

We estimate the Bank of Georgia's net income reached USD 81 mln in 2011 for a ROE of 18%, slightly exceeding management expectations from the start of the year. We see the bank's net interest revenues growing 14% yoy in 2012, supported by an 18% yoy increase in net loans while net fees and commissions are projected to add 20% yoy, in line with the previous year. We expect cost of risk to remain slightly below 1% in 2012 and the bank to improve its net income 20% yoy to USD 97 mln. Yet, its ROE is likely to decline 0.8 pp yoy due to an increase in equity following conversion of the IFC and EBRD's subordinated loans.

Use of revenues, USD mln

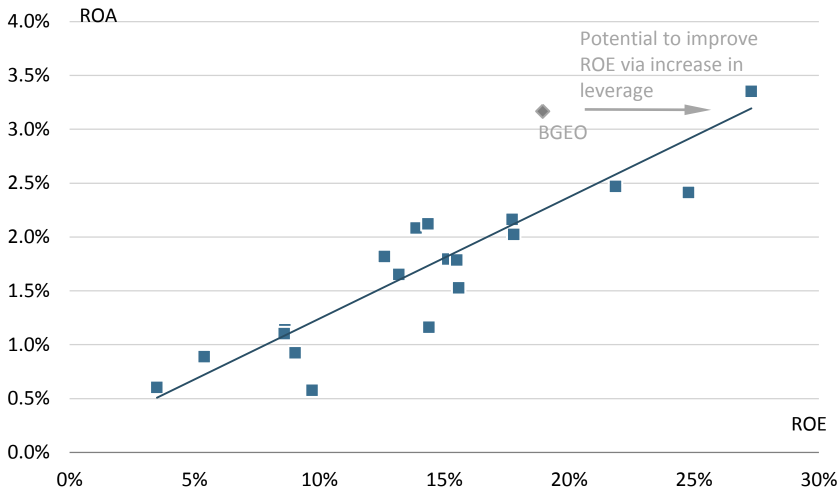


Source: Company data, Concorde Capital

Thanks to growing cost efficiency and a continued decline in cost of risk, the bank is making good progress in improving its return on total assets. We estimate ROA increased a hefty 0.9 pp yoy to 3.2% in 2011, expect it will increase by another 0.4 pp over the next three years, and see a long-term sustainable ROA of 3.6%. With good progress on that front, achieving targeted ROE of 20%+ is becoming a question of balance sheet leverage (assets-to-equity).

Benchmarking Bank of Georgia against a sample of CEE, Turkish and Kazakh banks reveals the bank has lots of potential for boosting ROE in the mid-term by improving leverage.

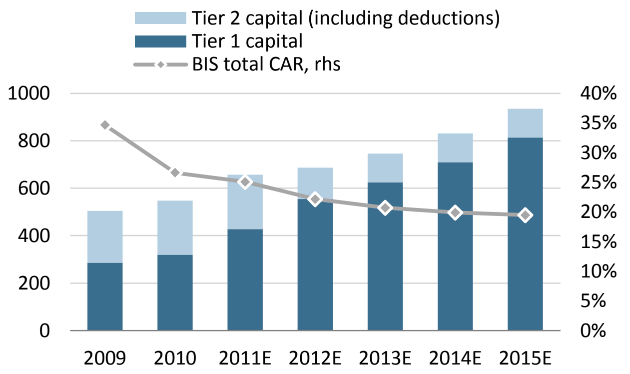
2011E ROE vs. ROA: Bank of Georgia vs. peers*



**See please table on page 19 for the list of peers.*
Source: Bloomberg, Concorde Capital

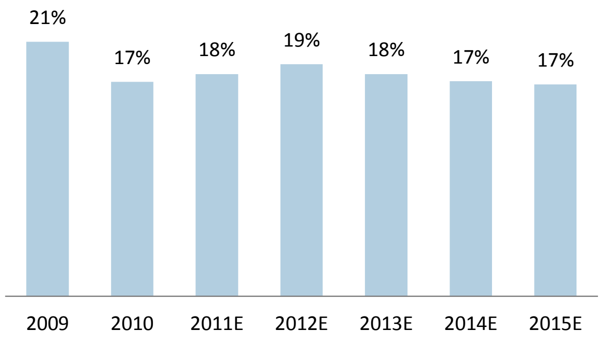
With an end-9M11 BIS total CAR of 26.1% (and equity-to-assets ratio of 18%), the bank looks overcapitalized/underleveraged. The high capital buffers are a product of strict NBG regulations: the regulator discourages local banks from holding FX assets by applying a punitive weighting of 175% in calculating CAR (conversely, BIS standards do not distinguish between GEL and FX-denominated assets). That said, the bank's total end-9M11 Tier 1 ratio under NBG methodology stood at 10.8% (vs. an 8% requirement) and total CAR stood at 15.0% (vs. a 12% floor).

Capital base and BIS CAR *



** Forecasts assume a 40% annual dividend payout starting in 2013*
Source: Company data, Concorde Capital

Equity to assets*



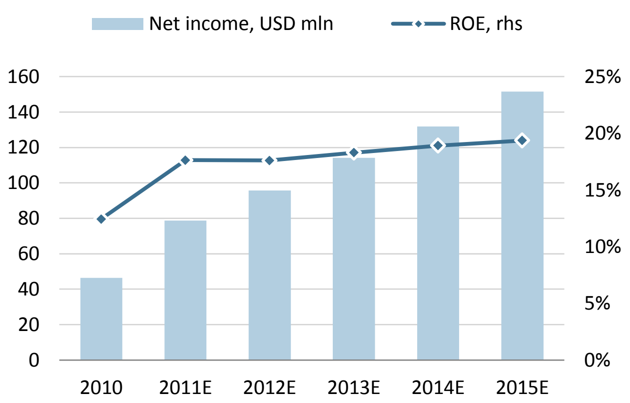
** Forecasts assume a 40% annual dividend payout starting in 2013*
Source: Company data, Concorde Capital

Bank of Georgia has excess capital even under NBG's extremely conservative standards and is essentially faced with two options:

- Maintain a 20%+ asset growth rate (above the ROE target) to tie up excess capital. Management expects 26% annual growth in assets over 2010-13. This looks improbable as we see the bank's balance sheet growing at a maximum 5Y CAGR of 16%, which implies the bank will continue to accumulate excess capital. If that were the case, achieving and sustaining 20%+ ROE (as targeted by management) would be a real challenge.
- Increase its dividend yield from 11% in 2010. This option looks doable, but we note that management might prefer to maintain a healthy capital buffer that would allow it to capitalize on new growth opportunities.

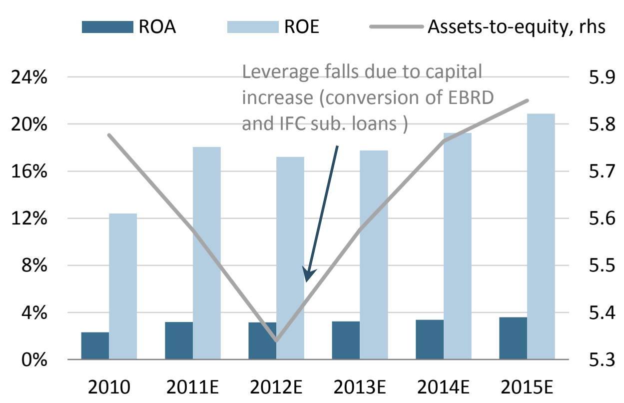
We expect Bank of Georgia's leverage to improve to above 5.8x by 2015 (assuming the dividend payout grows to 40% of net income starting in 2013), prompting ROE to increase to above 20%.

Net income and ROE*



** Forecasts assume a 40% annual dividend payout starting in 2013*
Source: Company data, Concorde Capital

ROA, ROE and leverage*



** Forecasts assume a 40% annual dividend payout starting in 2013*
Source: Company data, Concorde Capital

VALUATION

We derive our target price from DCF model. Our 12M TP of USD 24.1/share implies 84% upside to the current price, and we initiate coverage with a BUY recommendation. We account for a prospective share capital increase due to conversion of the EBRD and IFC subordinated loans expected through 2012 and take 36.51 million of shares to derive our target price.

Currently, we use a 2.0% company-specific premium in deriving cost of equity to reflect risks related to the legal restructuring of the group. Yet, we note that such an assumption is very conservative and the premium may be phased out as the bank successfully proceeds with the restructuring.

COE assumptions

	2011	2012	2013	2014	2015	2016	2017
Cost of equity	**16.5%**	**16.5%**	**16.5%**	**16.5%**	**16.5%**	**16.5%**	**16.5%**
Gov't Eurobond yield	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Equity risk premium	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Company-specific premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%

Source: Concorde Capital

DCF model, GEL mln unless other specified

	2012E	2013E	2014E	2015E	2016E	2017E
Net income	160	193	234	286	344	414
RWA	5,057	5,745	6,667	7,672	8,897	10,277
Change in RWA	690	688	922	1,005	1,225	1,380
Targeted Tier 1 ratio (marginal capital charge)	10%	10%	10%	10%	10%	10%
Net income retention					114	138
FCF to shareholders	160	193	234	286	230	276
COE	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%
Discount factor	0.86	0.74	0.63	0.54	0.47	0.40
Discounted FCF to shareholders @ February-13	138	142	148	156	107	110
Terminal value						2,187

Sum of discounted FCF (2013-17)	663
Discounted terminal value	875
Bank value @February-13	1,538
Implied FV / YE12 B	1.5
Number of shares @ February-13 (fully diluted)	36.513mln
Value per share, GEL	42.1
Value per share, USD	24.1

Terminal value assumptions	
Perpetuity growth rate	3.0%
COE in perpetuity	16.0%

Source: Concorde Capital

Sensitivity of value per share, USD

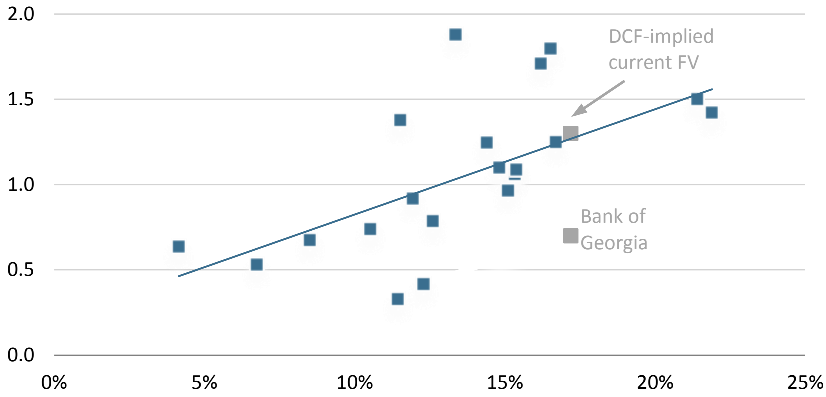
		Perp. growth rate				
		+2pp	+1pp	3.0%	-1pp	-2pp
COE	-2pp	29.0	27.6	26.3	25.2	24.3
	-1pp	27.8	26.3	25.1	24.1	23.2
	16.0%	26.6	25.2	**24.1**	23.1	22.2
	+1pp	25.4	24.1	23.1	22.1	21.3
	+2pp	24.3	23.1	22.1	21.2	20.4

Source: Concorde Capital

Peer valuation

Bank of Georgia currently trades at a 36% discount to its peers based on 2012E P/B, which we think is unjustified given its superior 2012E ROE of 17%.

ROE vs. P/B, 2012E



Source: Bloomberg, Concorde Capital

Peer comparison summary*

			P/B		P/E		ROE	
			2011E	2012E	2011E	2012E	2011E	2012E
Bank of Georgia	Georgia	BGEO LI	0.8	0.7	5.3	4.4	18.0%	17.2%
Premium/(discount) to mean			-29%	-36%	-47%	-48%	4.1pp	3.7pp
PKO BP	Poland	PKO PW	2.0	1.8	11.7	11.5	17.4%	16.5%
Bank Pekao	Poland	PEO PW	2.0	1.9	14.7	14.3	13.8%	13.4%
BRE	Poland	BRE PW	1.5	1.4	11.5	12.8	14.7%	11.5%
BZ WBK	Poland	BPH PW	0.7	0.6	15.6	13.8	4.8%	4.2%
OTP Bank	Hungary	OTP HB	0.8	0.7	10.9	8.6	8.3%	10.5%
BRD-Groupe Soc Ge	Romania	BRD RO	1.2	1.1	17.8	8.1	14.8%	14.8%
Komercni Bank	Czech Rep.	KOMB CP	1.8	1.7	12.8	10.9	15.1%	16.2%
Raiffeisen Bank International	Austria	RBI AV	0.7	0.7	7.7	7.9	9.7%	8.5%
Vozrozhdenie Bank	Russia	VZRZ RM	0.9	0.8	10.2	6.5	9.1%	12.6%
VTB	Russia	VTBR LI	1.2	1.1	8.5	7.5	15.5%	15.3%
Sberbank	Russia	SBER RU	1.7	1.4	6.7	6.7	27.3%	21.9%
Kazkommercbank	Kazakhstan	KKB LI	0.6	0.5	9.9	6.8	5.4%	6.8%
Halyk Savings Bank	Kazakhstan	HSBK LI	1.1	1.0	8.6	6.4	12.9%	15.1%
Akbank TAS	Turkey	AKBNK TI	1.4	1.2	10.6	9.0	13.7%	14.4%
Turkiye Garanti	Turkey	GARAN TI	1.4	1.3	9.1	8.0	16.3%	16.7%
Turkiye Is Bankasi	Turkey	ISCTR TI	1.0	0.9	7.7	7.7	13.0%	11.9%
Tapi Kredi	Turkey	YKBNK TI	1.3	1.1	7.9	7.8	17.8%	15.4%
Halk Bankasi	Turkey	HALKB TI	1.8	1.5	7.6	7.4	25.3%	21.4%
Ukrsotsbank	Ukraine	USCB UK	0.3	0.3	6.4	2.9	7.3%	11.5%
Raiffeisen Bank Aval	Ukraine	BAVL UK	0.4	0.4	3.8	4.2	15.4%	12.3%
Mean			**1.2**	**1.1**	**10.0**	**8.4**	**13.9%**	**13.5%**

*Data as of February 13, 2012

Source: Bloomberg, Concorde Capital

FINANCIALS, IFRS

Income statement, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Interest income	271	227	237	303	357	411	478	556
Interest expense	-123	-113	-116	-164	-198	-233	-272	-316
Net Interest Income	148	114	121	139	158	178	206	240
Net fees & commission income	34	33	36	43	52	60	68	78
Net other non-interest income	44	31	38	56	52	62	72	84
Total Non-Interest Income	77	64	73	99	103	122	140	161
Total operating revenues	225	178	194	238	262	300	346	401
Personnel costs	-73	-60	-59	-70	-78	-86	-94	-104
Other operating expenses	-69	-106	-56	-59	-54	-59	-64	-69
Total operating costs	-142	-166	-115	-129	-132	-145	-158	-173
Profit/(loss) before provisions	83	12	80	109	129	155	187	228
Net provision expense	-83	-75	-25	-14	-15	-17	-20	-24
Pre-tax income/(loss)	-1	-63	55	95	114	138	167	204
Income tax benefit/ (expense)	1	4	-9	-14	-17	-21	-25	-31
Net income/(loss)	0	-59	46	81	97	117	142	174

Balance sheet, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Cash and cash equivalents	99	92	91	108	174	209	223	251
Amounts due from credit institutions (incl. NBG)	200	159	319	488	585	688	805	934
Loans to clients, net	1 223	985	1 327	1 585	1 864	2 187	2 588	3 006
Loans to individuals	639	573	858	1 042	1 229	1 438	1 697	1 969
Loans to legal entities	648	512	567	665	771	902	1 064	1 235
Allowance for loan impairment	-64	-99	-99	-121	-136	-153	-174	-197
Fixed income securities	34	159	166	223	259	301	349	405
PPE and intangible assets	272	216	213	226	236	242	248	255
Other Assets	127	117	143	184	213	243	277	316
Total Assets	1 955	1 728	2 259	2 815	3 331	3 869	4 490	5 166
Client deposits	716	755	1 131	1 478	1 798	2 143	2 554	2 988
Legal entities	418	376	626	855	1 068	1 282	1 538	1 800
Individuals	297	378	504	623	729	861	1 015	1 188
Amounts due to credit institutions	429	183	302	482	682	784	886	1 001
Eurobonds	204	180	153	56	0	0	0	0
Subordinated debt	96	189	187	190	104	104	104	104
Other liabilities	78	68	95	105	124	144	167	190
Total liabilities	1 524	1 373	1 868	2 310	2 708	3 175	3 711	4 283
Total equity	431	355	391	505	624	694	779	883
Liabilities & equity	1 955	1 728	2 259	2 815	3 331	3 869	4 490	5 166

Financial ratios

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Growth								
Assets	5%	-12%	31%	25%	18%	16%	16%	15%
Net loans	16%	-19%	35%	20%	18%	17%	18%	16%
Deposits	-16%	5%	50%	31%	22%	19%	19%	17%
Profit/(loss) before provisions	28%	-86%	572%	37%	18%	20%	21%	22%
Net income/(loss)	nm	nm	nm	75%	20%	20%	21%	22%
Profitability								
ROAE	0.0%	-15.1%	12.4%	18.0%	17.2%	17.7%	19.2%	20.9%
ROAA	0.0%	-3.2%	2.3%	3.2%	3.2%	3.2%	3.4%	3.6%
Interest spread	9.9%	8.8%	8.6%	7.6%	7.6%	7.3%	7.2%	7.1%
Net interest margin	9.7%	8.6%	8.4%	7.2%	7.1%	6.8%	6.7%	6.7%
Total operating revenues / average assets	11.8%	9.7%	9.8%	9.4%	8.5%	8.3%	8.3%	8.3%
Liquidity								
Net loans / total assets	63%	57%	59%	56%	56%	57%	58%	58%
Interest earning assets / total assets	75%	75%	80%	82%	81%	82%	83%	84%
Net loans / client deposits	171%	131%	117%	107%	104%	102%	101%	101%
Client deposits / total liabilities	47%	55%	61%	64%	66%	67%	69%	70%
Efficiency								
Cost/income ratio	63.3%	93.3%	58.9%	54.1%	50.6%	48.4%	45.8%	43.1%
Operating cost / average total assets	7.5%	9.0%	5.8%	5.1%	4.3%	4.0%	3.8%	3.6%
Asset quality								
Cost of risk	7.1%	6.3%	2.0%	0.9%	0.8%	0.8%	0.8%	0.8%
Reserve for loan losses / gross loans	5.0%	9.1%	6.9%	7.1%	6.8%	6.5%	6.3%	6.2%
Capital								
Equity to assets	22.1%	20.5%	17.3%	17.9%	18.7%	17.9%	17.4%	17.1%
BIS total capital adequacy	26.6%	34.7%	26.6%	24.8%	22.4%	21.4%	20.6%	20.1%
Per share								
BPS, USD	13.8	11.3	12.5	15.4	17.1	19.0	21.3	24.2
EPS, USD	0.00	-1.89	1.48	2.46	2.66	3.20	3.88	4.76
DPS, USD	0.00	0.00	0.00	0.17	0.80	1.28	1.55	1.90

Source: Company data, Concorde Capital

APPENDICES

Georgian economy: faring well amid global turbulence

A global top reformer

Georgia delivered impressive progress in terms of structural and institutional reform in the last couple of years and stands out among its peers on many important metrics: it was ranked #16 (out of 183, up from #112 in 2005) on Ease of Doing Business by the World Bank and #29 (out of 183, up from #99 in 2005) on the Economic Freedom Index by the Heritage Foundation.

Country brief

Area	69,700 km^2
Population	4.47 million
Literacy	100%
Currency (code)	Lari (GEL)
GDP, 2010	USD 11.6 bln
GDP per capita, 2010	USD 2,623
GDP per capita, 2010 PPP	USD 5,057
2011 real GDP growth	+6.8% yoy
WB Ease of Doing Business	16 (of 183)
Economic freedom index	29 (of 183)

Sources: Government of Georgia, GeoStat

Sovereign ratings

S&P	
LT FC	BB-
ST FC	B
Fitch	
LT FC	BB-
ST FC	B
Moody's	
LT FC	Ba3
ST FC	Not-prime

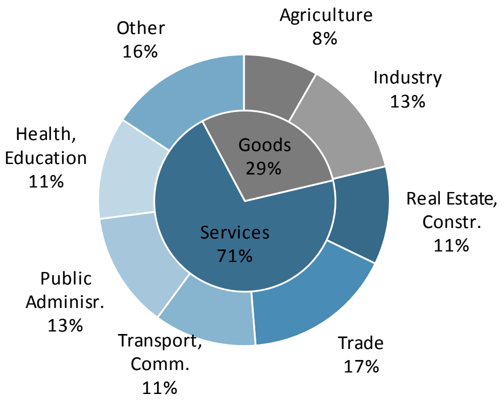
Sources: Rating agencies

Economic growth strong, driven by industry and services

The country's GDP expanded 8.1% yoy in 4Q11 and 6.8% yoy in 2011. On the demand side, we estimate domestic private consumption was the largest growth driver, while the contribution of net exports was close to zero. While the economy is likely to decelerate in 2012, in line with global trends (especially as the economies of Georgia's key trading partners except Azerbaijan are slowing), it should still remain among the fastest growing in the region.

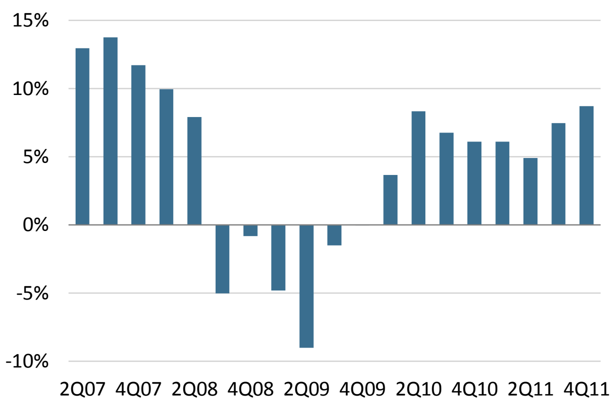
Georgia's economy is heavily reliant on the service sector: industry and agriculture account for just 13% and 8% of GDP, respectively. The government is targeting policies to enhance competitive advantages by investing heavily into infrastructure, with a special focus on the development of transportation and tourism.

Georgia's GDP structure by sectors, 2010



Source: GeoStat

Real quarterly GDP, chg. yoy

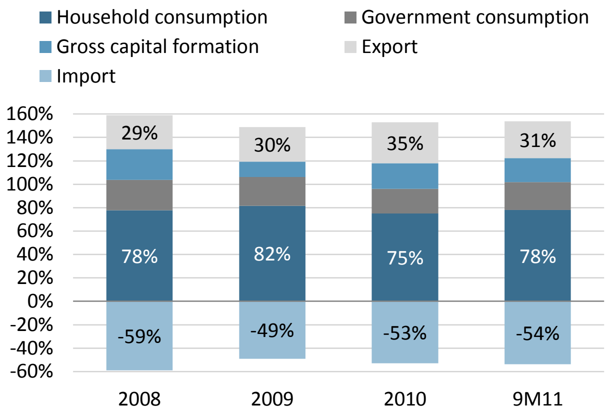


Source: GeoStat

Inflation abated on eased food price pressures

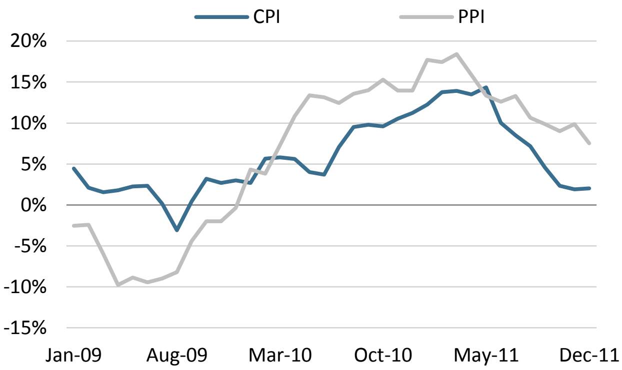
Georgia's inflation accelerated in 2H10-1H11, peaking at 14.3% yoy in May 2011, before reversing sharply in 2H11 on the back of easing food price pressure in the region. End-2011 CPI stood at a mere 2.0% yoy and we expect inflation to remain muted in Georgia at least in 2012.

Georgia's GDP breakdown by expenditures, 2010



Source: GeoStat

CPI and PPI, yoy



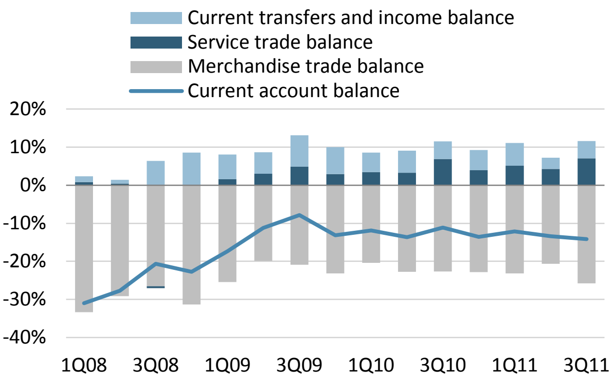
Source: GeoStat

Inherently large trade and C/A deficits covered by FDI and debt

As with many small economies, Georgia has an inherently large merchandise trade deficit – the shortfall stood at USD 2.4 bln in 9M11 (23% of 9M11 GDP). Yet, a positive balance of trade in services (supported by exports of tourism and transportation) and sizable migrant remittances offset a large portion of the gap. The country's C/A deficit stood at 13% of GDP in 9M11, widening from 12% in 9M10.

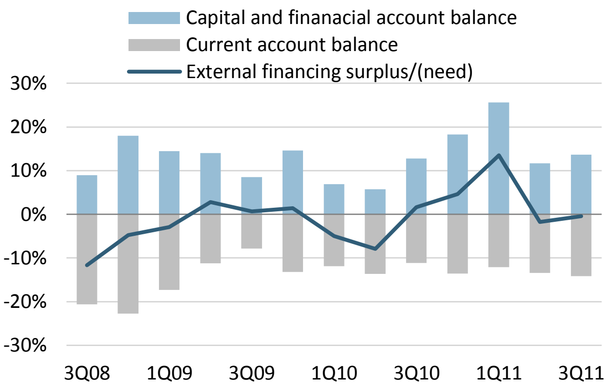
Despite persisting global capital market jitters, Georgia's C/A shortfall was fully offset by FDI and debt inflows. FDI reached USD 0.65 bln in 9M11 (6.3% of GDP), up 8% yoy. We admit that the sizable C/A deficit remains the key risk for the economy and healthy inflow of FDI and debt are crucial for maintaining economic stability.

Current account balance, % of GDP



Source: Concorde Capital estimates

External financing surplus/(need), % of GDP



Source: Concorde Capital estimates

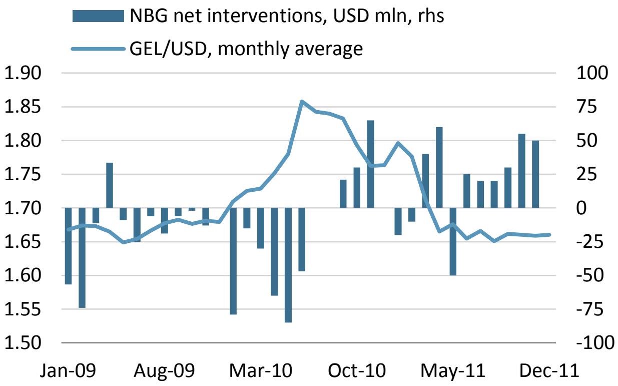
National currency stable, NBG reserves replenished

As net capital inflows remain strong and continue to exceed the C/A gap, Georgian's FX market was dominated by sellers last year. The Lari appreciated 7% vs. the US dollar since the beginning of 2011, while most of regional and CEE currencies depreciated against weakening capital inflows. The central bank remained a net buyer of FX for most of the year and brought its gross international reserves to USD 2.8 bln as of end-2011, up 24% yoy (equivalent of 4.2-months of import of goods and services in 2011E).

Successful IMF program

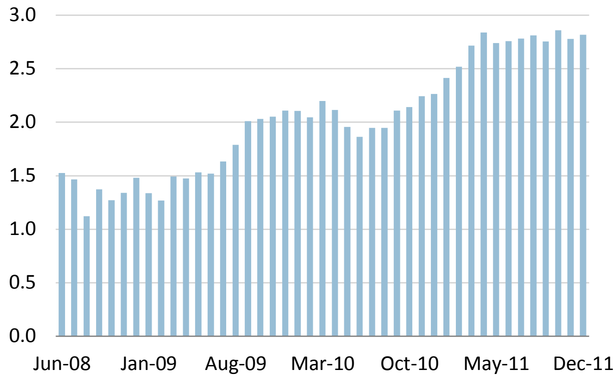
To mitigate external financing risks, Georgia launched a standby loan program with the International Monetary Fund back in September 2008. The country drew USD 0.93 bln of an available USD 1.2 bln. In its final review, the IMF said program objectives had largely been achieved. We estimate IMF funds account for about 35% of the National Bank of Georgia's end-2011 gross international reserves.

Net NBG FX interventions and GEL/USD rate*



** Positive numbers indicate net FX purchases*
Source: NBG

NBG gross international reserves, USD bln



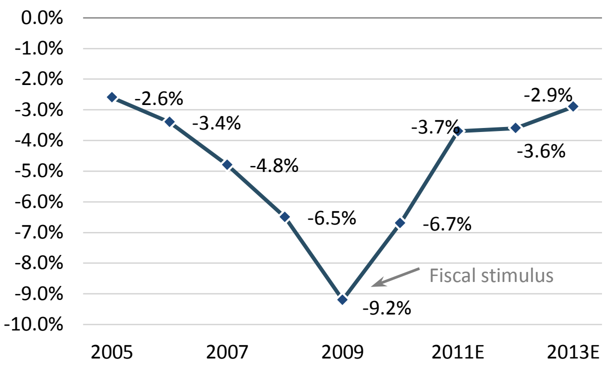
Source: NBG, Concorde Capital

Prudent fiscal policy

Georgia's government remains committed to reducing its fiscal gap and recent fiscal consolidation has been successful, in our view. The budget's cash deficit shrank from 9.2% of GDP in 2009 to an estimated 3.7% in 2011. The government estimates end-2011 public debt at 40% of GDP. External public debt carries a mere 2% interest rate (weighted-average).

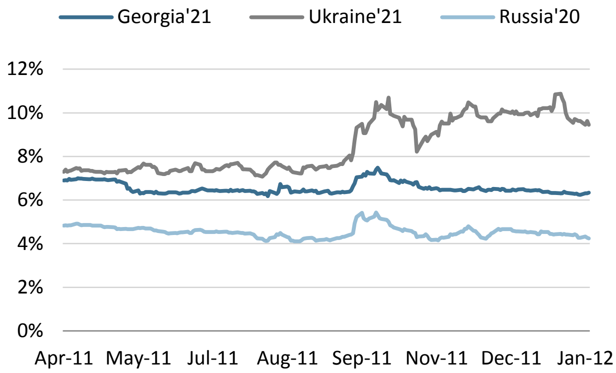
In April 2011, the government placed a USD 500 mln 10-year Eurobond and redeemed USD 417 mln of its USD 500 mln Eurobond maturing in 2013, substantially easing the maturity profile of its debt. Investor perception of Georgia's economy remains positive – yields on sovereign paper are now close to 6.4% and have been 6.2-7.5% throughout 2011.

Budget cash deficit, % of GDP



Source: Government of Georgia

Georgia Eurobond yield vs. Ukraine and Russia

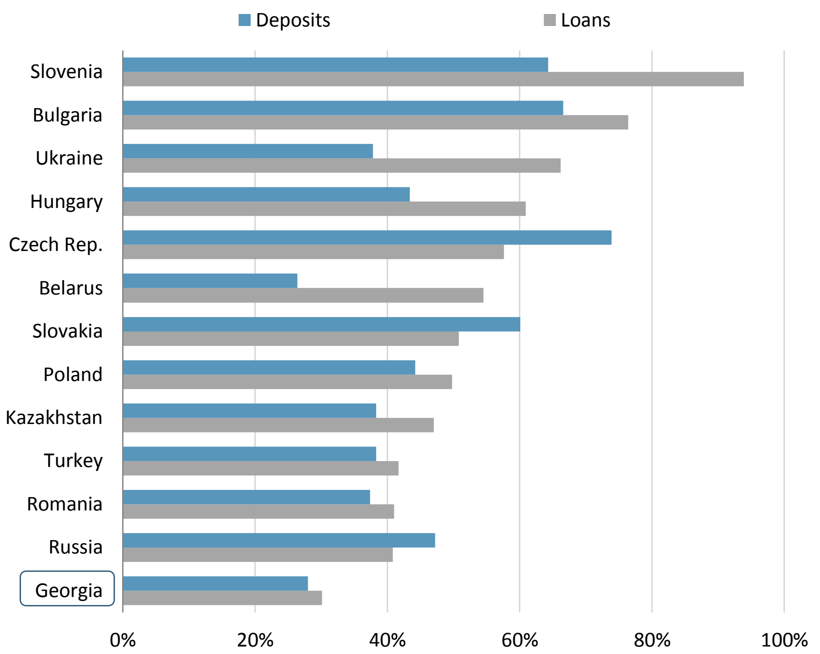


Source: Bloomberg

Georgian banking sector: fundamentally strong

Georgia's banking sector has one of the lowest penetration ratios among CEE countries (end-2011 assets-to-GDP, loans-to-GDP and deposits-to-GDP ratios of 51%, 30% and 28%, respectively).

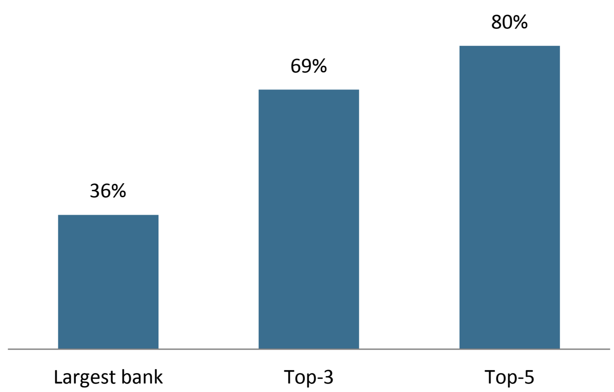
Loans and deposits in CEE, % of GDP, 2011E



Source: National sources, Concorde Capital

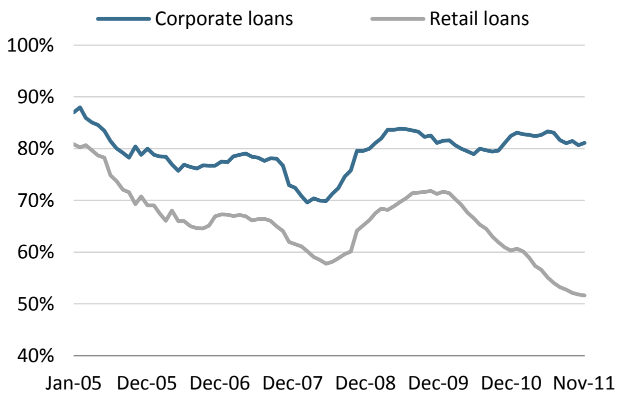
Of the country's 19 banks, 16 are controlled by non-residents. The sector is strongly concentrated with Bank of Georgia holding a 36% market share by assets as of end-2011. Bank balance sheets are heavily dollarized – the end-2011 share of lari loans stood at just 31% (19% in the corporate segment and 48% in retail).

Share of largest banks in total sector assets, end-2011



Source: NBG, Concorde Capital

FX loans as % of total loan book

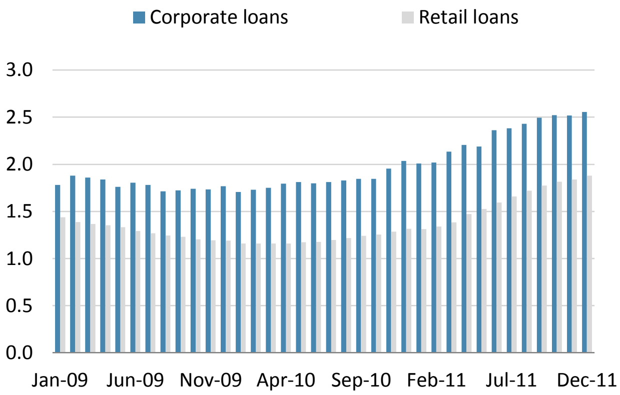


Source: NBG

Lending remains robust

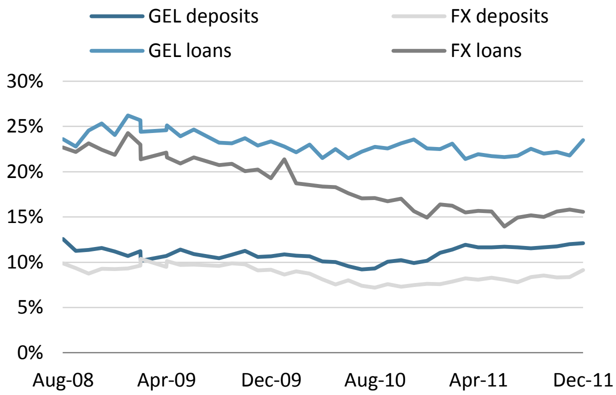
The sector's loan book bottomed out in 1Q10 and since then banks have been seeing steady demand for new loans, both corporate and retail. On the corporate side, the bulk of demand for fresh loans comes from trade and industry, the two sectors that benefited the most from booming commodity exports. In the retail segment, consumer loans are leading lending growth. Total lending was up 28% in 2011 (net of FX effects).

Banking sector loans, USD bln



Source: NBG, Concorde Capital

Banking sector deposit and loan interest rates



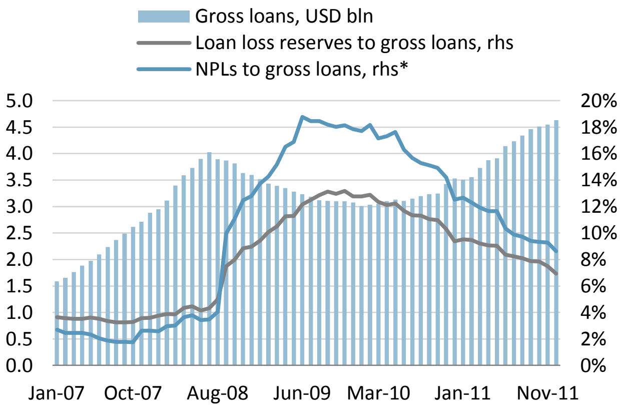
Source: NBG, Concorde Capital

Loan quality healthy, capital positions safe

The banking sector's loan quality remains high with end-2011 NPLs (substandard, doubtful and loss loan categories) amounting to 8.6% (vs. 18.8% at the height of the crisis in mid-2009) with a coverage ratio of 80%. NPLs as a share of total loans are declining, although this is in part due to the expanding loan book. With banks slashing loan loss provisions in 2011, the sector's ROE improved to 17.3% last year from 9.6% in 2010.

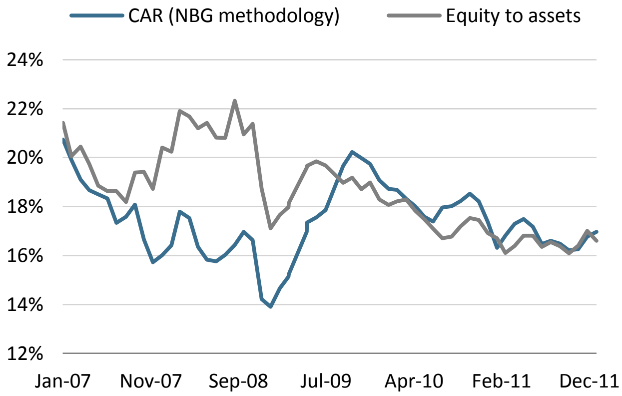
The sector's capital position was strong even at the height of the crisis, with total CAR (under NBG methodology) remaining well above the required 12% minimum.

Loan quality and loan loss provisions



** NPLs are defined as substandard, doubtful and loss loan categories*
Source: NBG, Concorde Capital

Banking sector capital position

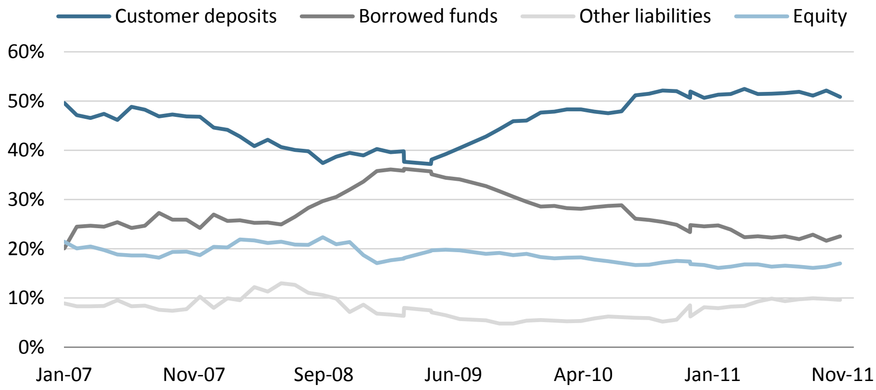


Source: NBG, Concorde Capital

Reliance on customer deposits increases

The structure of the sector's funding base was volatile over the past couple of years. The share of customer deposits in total liabilities shrank to only 46% in April 2009 in the wake of the crisis-induced run on deposits, but the trend reversed thereafter. As of end-2011, the share of customer deposits in the total funding base stood at 51%, as both households and businesses returned savings to banks. Deposits grew 31% on an FX-adjusted basis in 2011.

Structure of banking sector funding (equity and liabilities)



Source: NBG, Concorde Capital

Analyst certification

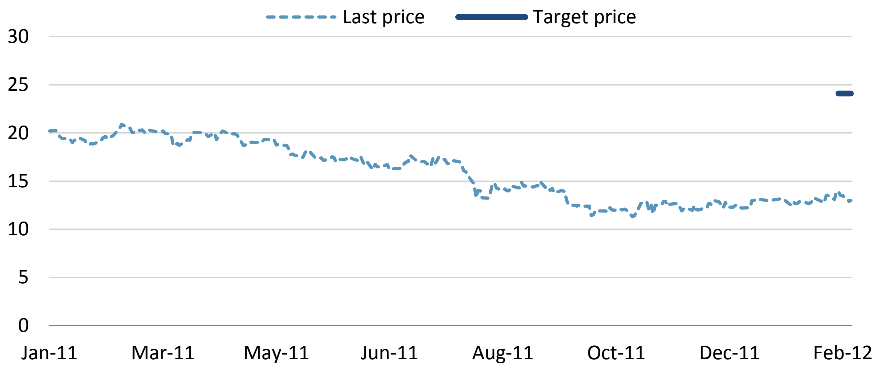
We, Olena Zuikova and Vitaliy Vavryshchuk, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Company: Rating history

Date	*12M target price, USD*	*Market price, USD*	*Rating*	*Action*
14-Feb-2012	24.1	13.1	BUY	Initiating

Source: Concorde Capital

Company: Target price vs. share performance, USD per share



Source: Bloomberg, Concorde Capital

Investment ratings

The time horizon for target prices in Concorde Capital's research is 12 months unless otherwise stated. Concorde Capital employs three basic investment ratings: Buy, Hold and Sell. Typically, Buy recommendation is associated with an upside of 20% or more from the current market price; Sell is prompted by downside from the current market price (upside <0%); Hold recommendation is generally for limited upside within 20%. Though investment ratings are generally induced by the magnitude of upside, they are not derived on this basis alone. In certain cases, an analyst may have reasons to establish a recommendation where the associated range given above does not correspond. Temporary discrepancies between an investment rating and its upside at a specific point in time due to price movement and/or volatility will be permitted; Concorde Capital may revise an investment rating at its discretion. A recommendation and/or target price might be placed Under Review when impelled by corporate events, changes in finances or operations. Investors should base decisions to Buy, Hold or Sell a stock on the complete information regarding the analyst's views in the research report and on their individual investment objectives and circumstances.

Contacts

CONCORDE CAPITAL
2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.ua
Bloomberg: TYPE CONR <GO>

CEO
Igor Mazepa im@concorde.com.ua

SALES

Head of Sales & Trading
Luba Yurchyk ly@concorde.com.ua

International Sales & Trading
Katerina Shevchenko ksh@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua
Rostyslav Shmanenko rs@concorde.com.ua

RESEARCH

Head of Research
Alexander Paraschiy ap@concorde.com.ua

Agriculture, Consumer
Yegor Samusenko syg@concorde.com.ua

Economics
Svetlana Rekrut sr@concorde.com.ua

Machinery
Roman Dmytrenko rd@concorde.com.ua

Utilities, Telecommunications
Alexander Paraschiy ap@concorde.com.ua

Fixed income, Energy
Vitaliy Vavryshchuk vv@concorde.com.ua

Basic Materials
Roman Topolyuk rt@concorde.com.ua

Financials
Olena Zuikova olz@concorde.com.ua

Corporate governance, Politics
Brad Wells bw@concorde.com.ua

Editor
Brad Wells bw@concorde.com.ua