

October 4, 2012

# Bank of Georgia Holdings

## Election pullback presents attractive entry point

Political risk behind Bank of Georgia Holdings has ticked up due to the unknowns related to Monday's election winner Bidzina Ivanishvili and his plans to bring in an entirely new government, sending shares down 8.1% in the last two days. However, we do not see a sharp policy turn in the pro-Western, pro-market post-Rose Revolution country and continue to like the Bank of Georgia's long-term investment case. We stand by our 12-month TP of USD 23.7, which implies 25% upside from yesterday's close.

**Ivanishvili's competence & new government elevate risk.** We see increased political risk behind Bank of Georgia related to Monday's election winner, Bidzina Ivanishvili's, blank track record and plans to bring in an entirely new cabinet. The bank also stands to lose its comfortable relationship with the government (CEO Iralki Gilauri and longtime prime minister under Saakashvili, Nika Gilauri (Feb. 2009-July 2012), are brothers). Though, Ivanishvili's pledges to maintain the pro-democratic, pro-Western and economic policies of his predecessor are encouraging. During a conference call yesterday, Iralki Gilauri said he expected it to be a few months before the new government's true trajectory becomes apparent, but that he saw "big upside" from plans to repair Russian ties (a move welcomed by Russian Prime Minister Dmitry Medvedev).

**Bank of Georgia's investment case remains strong.** We continue to be believers in Bank of Georgia's long-term investment case. The nation's largest lender has built a strong reputation for independence and for protecting shareholder value (more than 95% of its shares are free float). Bank of Georgia's have retreated 8.8% in the last two sessions, presenting an attractive entry opportunity for those ready to weather the current political uncertainty. We do not see a sharp turn in government policy and believe the overall political backdrop will remain supportive. We stand by our 12-month TP of USD 23.7/share, which implies 25% upside from yesterday's close.

**Ivanishvili is likely to step in as prime minister.** Georgian Dream's victory makes it likely leader Ivanishvili will be installed in the position he set out to hold - prime minister. Ivanishvili's business empire has included assets in financial services and real estate; his net worth was estimated at USD 6.4 bln by Forbes in March 2012 (#1 in Georgia, #153 in the world). He is the nominal owner of Georgia's Cartu Bank (#9 by assets as of end-1Q12) and has reportedly divested most of his other assets during his campaign. The next prime minister will receive many of the president's executive powers after Saakashvili steps down when his second term expires in October 2013.

### Parliamentary election results

Political party	Exit poll	Official result
Georgian Dream (Ivanishvili)	51%	55.1%
United National Movement (Saakashvili)	40%	40.1%
Christian Democratic Union (Targamadze)	5%	2.0%
Labor Party (Natelashvili)	-	1.2%

Note: Exit poll by Edison Research for Imedi and Rustavi 2 TV stations based on 10,485 interviews with a margin of error of ±2. Official results according to the Georgian Central Election Commission as of October 3, 2012 with 94% of ballots counted (3,542 precincts out of 3,766).

Source: Edison Research, Election Administration of Georgia

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Bloomberg	BGEO LN
Reuters	BGEO.L
<b>Recommendation</b>	<b>BUY</b>
Price, USD	18.9
Price, GBP	1175
12M target, USD	23.7
12M target, GBP	1469
Upside	25%
No of shares, mln	35.9
Market Cap, USD mln	679
Performance*	10.4%
ADT, USD mln*	1.83
Free float, %	99%
Free float, USD mln	574

\*Since start of trading on Feb. 28, 2012

Note: Data as of October 3, 2012

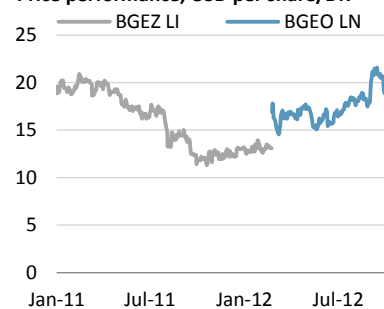
Source: Bloomberg

### Top-5 Bank of Georgia shareholders

East Capital AB	18.4%
Firebird Advisors	8.0%
Royal Bank of Canada	6.8%
Prosperity Capital Management	4.9%
East Capital Asset Management	4.9%

Source: Bloomberg

### Price performance, USD per share/DR



Note: BGEZ LI is the ticker for Bank of Georgia DRs, BGEO LN is the ticker for Bank of Georgia Holdings (BGH) ordinary shares.

Source: Bloomberg

## BANK OF GEORGIA HOLDINGS

### Valuation

We derived our Bank of Georgia Holdings target price using a DCF model. We employed a 2.0% company-specific premium in deriving cost of equity to reflect risks related to the legal restructuring of the group (see our Initiating Coverage report of February 2012 for more). Our 12-month target price of USD 23.7 per share offers 25% upside from yesterday's close.

### Risks

We see the following key risks that could impede Bank of Georgia Holdings shares from reaching our target price:

- **International political level:** Georgia is at an uneasy standstill over the status of breakaway republics South Ossetia and Abkhazia following military operations involving Georgia and Russia in 2008. Georgia considers the regions to be autonomous republics while several nations including Russia have acknowledged the regions as independent.
- **Domestic political level:** The victory of opposition party Georgian Dream in the October 1 parliamentary election paves the way for a democratic political transition. President Mikheil Saakashvili has said his United National Movement will move peacefully into opposition, but there is the potential for obstruction and turbulence during the transition and while Saakashvili co-exists with an opposition parliament until the end of his term in 2013. In addition, there is uncertainty because of Bidzina Ivanishvili's blank political track record and plans to bring in an entirely new cabinet.
- **Industry level:** Competition is increasing as rival banks are making up ground in expertise and broadly replicating Bank of Georgia's corporate management and customer care strategies. Ivanishvili, according to the National Bank of Georgia, still holds stakes in two small Georgian banks, though their relatively small size and popular word on the ground suggest they will do not pose a significant challenge to the Bank of Georgia's position.

## SOUND 1H12 FINANCIALS

The Bank of Georgia Holdings' 2Q and 1H12 results confirm our bullish view. The bank remains well-capitalized and delivers a sound return on its capital well above the median for FTSE-350 financial stocks (19.1% in 2012E vs. the median of 7.4%).

### 1H12 financial results under IFRS, USD mln (unless other specified)

	1H12	1H11	yoY
Net int. income	83.7	69.5	20.4%
Total revenue	145.3	128.1	13.4%
Total profit	52.3	38.3	36.5%
Basic EPS, USD	1.56	1.28	22.3%
Assets	3,000	2,474	21.2%
Net loans	1,777	1,464	21.4%
Deposits	1,667	1,248	33.6%
Equity	582	451	29.0%
ROE	18.6%	17.6%	1.0 pp
Net int. margin	8.2%	7.9%	0.3 pp
Cost / Income	45.6%	48.5%	-2.9 pp
NPLs	3.3%	3.9%	-0.6 pp
BIS total CAR	28.1%	26.7%	1.4 pp

Source: Company data

# ANNUAL FINANCIALS, IFRS

## Income statement, USD mln

	2009	2010	2011	2012E	2013E	2014E	2015E
Interest income	227	237	297	336	372	431	500
Interest expense	-113	-116	-158	-179	-197	-227	-261
Net Interest Income	114	121	139	158	175	204	239
Net fees & commission income	33	36	45	48	56	63	72
Net other non-interest income	30	38	78	77	87	99	113
Total Non-Interest Income	62	73	123	125	143	162	185
Total operating revenues	177	194	262	282	318	367	424
Personnel costs	-60	-59	-71	-79	-87	-95	-105
Other operating expenses	-57	-53	-58	-60	-65	-70	-76
Total operating costs	-117	-112	-129	-138	-151	-165	-180
Profit/(loss) before provisions	60	82	133	144	166	201	244
Net provision expense	-71	-28	-14	-16	-18	-19	-23
Non-operating income/loss	-52	1	-26	-9	-3	0	0
Pre-tax income/(loss)	-63	55	93	119	145	182	221
Income tax benefit/( expense )	4	-9	-13	-18	-22	-27	-33
Net income/(loss)	-59	46	80	101	123	155	188

## Balance sheet, USD mln

	2009	2010	2011	2012E	2013E	2014E	2015E
Cash and cash equivalents	92	91	98	134	145	126	142
Amounts due from credit institutions (incl. NBG)	159	319	452	392	455	525	605
Loans to clients, net	985	1,327	1,529	1,807	2,110	2,489	2,885
Loans to individuals and SME	557	804	816	975	1,141	1,346	1,561
Loans to legal entities	527	622	781	918	1,073	1,267	1,469
Allowance for loan impairment	-99	-99	-69	-85	-104	-123	-146
Fixed income securities	159	166	251	267	310	359	417
PPE and intangible assets	216	213	249	258	264	271	278
Other Assets	117	143	215	261	297	339	386
Total Assets	1,728	2,259	2,793	3,118	3,581	4,109	4,713
Client deposits	755	1,143	1,638	1,900	2,204	2,557	2,966
Legal entities	377	639	1,005	1,170	1,357	1,574	1,826
Individuals	378	504	633	730	847	983	1,140
Amounts due to credit institutions	183	302	304	338	388	439	496
Eurobonds	180	153	57	0	0	0	0
Subordinated debt	189	187	190	107	107	107	107
Other liabilities	67	83	118	139	161	186	211
Total liabilities	1,373	1,868	2,307	2,484	2,861	3,288	3,780
Total equity	355	391	487	634	720	821	933
Liabilities & equity	1,728	2,259	2,793	3,118	3,581	4,109	4,713

## Financial ratios

	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Growth</b>							
Assets	-12%	31%	24%	12%	15%	15%	15%
Net loans	-19%	35%	15%	18%	17%	18%	16%
Deposits	6%	51%	43%	16%	16%	16%	16%
Profit/(loss) before provisions	-28%	38%	61%	9%	16%	21%	21%
Net income/(loss)	nm	nm	73%	26%	22%	26%	22%
<b>Profitability</b>							
ROAE	-15.1%	12.4%	18.3%	18.1%	18.2%	20.1%	21.4%
ROAA	-3.2%	2.3%	3.2%	3.4%	3.7%	4.0%	4.3%
Interest spread	8.8%	8.6%	7.7%	7.5%	6.9%	6.7%	6.7%
Net interest margin	8.6%	8.4%	7.2%	7.2%	6.9%	6.9%	6.9%
Total operating revenues / average assets	9.6%	9.8%	10.4%	9.5%	9.5%	9.5%	9.6%
<b>Liquidity</b>							
Net loans / total assets	57%	59%	55%	58%	59%	61%	61%
Interest earning assets / total assets	75%	80%	80%	79%	80%	82%	83%
Net loans / client deposits	130%	116%	93%	95%	96%	97%	97%
Client deposits / total liabilities	55%	61%	71%	76%	77%	78%	78%
<b>Efficiency</b>							
Cost/income ratio	66.1%	57.6%	49.3%	49.0%	47.7%	45.1%	42.5%
Operating cost / average total assets	6.3%	5.6%	5.1%	4.7%	4.5%	4.3%	4.1%
<b>Asset quality</b>							
Cost of risk	6.0%	2.2%	0.9%	0.9%	0.9%	0.8%	0.8%
Reserve for loan losses / gross loans	9.1%	6.9%	4.3%	4.5%	4.7%	4.7%	4.8%
<b>Capital</b>							
Equity to assets	20.5%	17.3%	17.4%	20.3%	20.1%	20.0%	19.8%
BIS total capital adequacy	34.7%	26.6%	28.5%	26.7%	25.4%	24.5%	23.7%
<b>Per share</b>							
BPS, USD	11.3	12.5	14.8	17.4	19.7	22.5	25.6
EPS, USD	-1.89	1.48	2.45	2.77	3.37	4.24	5.15
DPS, USD	0.00	0.00	0.17	0.39	1.01	1.48	2.06

Source: Company data, Concorde Capital

## APPENDICES

### Appendix 1: Georgian political system

Georgia is a semi-presidential republic (it is set to shift to a semi-parliamentary republic after the current president steps down in October 2013). It declared independence from the Soviet Union on April 9, 1991. The government has three branches: executive, legislative and judicial. Georgia has nine regions, one city with a special status and two autonomous republics. Georgia's capital and largest city is Tbilisi. Georgia's constitution was adopted August 24, 1995 and was last amended October 15, 2010.

**President of Georgia.** Georgia's president is the head of state. The Georgian president is elected by popular vote for a five-year term. The current president, Mikheil Saakashvili, was inaugurated on January 20, 2008.

The Georgian president has the power to:

- Concludes international treaties and agreements and conducts negotiations with foreign states
- With the consent of Parliament, appoints Prime Minister and members of the Government; removes ministers from their posts
- Submits to Parliament the draft state budget
- Has the right to dissolve Parliament in accordance with procedures and conditions set out in the Constitution
- Acts as the Supreme Commander-in-Chief of the Armed Forces; appoints members of the National Security Council and chairs its meetings

**Cabinet of Ministers of Georgia.** Georgia's Cabinet of Ministers currently has five high state ministers and thirteen lower ministers. The Cabinet of Ministers is presided over by the Prime Minister.

**Parliament of Georgia.** The Supreme Council of the Republic of Georgia is a unicameral parliament with 150 seats. Following reforms enacted in 2011, 77 seats will be determined by party lists and the other 73 by single-member constituency voting districts. The parliament amends the Constitution, adopts laws, approves the state budget, ratifies and denounces international treaties, declares war and peace, and appoints officials and judges. The Supreme Council is presided over by a speaker.

## Appendix 2: Bidzina Ivanishvili profile

<b>Summary</b>	Businessman investor, billionaire, art collector. Reclusive and little-known prior to campaign announcement in October 2011.
<b>Net wealth (est.)</b>	USD 6.4 bln; #1 in Georgia, #153 in the world (Forbes, March 2012)
<b>Brief profile</b>	Began building his empire in 1990 when, with partner Vitaly Malkin, he set up Rossiysky Kredit Bank. Over the years, sold businesses he accumulated during Russia's privatization era including ore mining and metals interests; invested proceeds in Russian stock market. Also has interests in elite real estate project in Moscow and two 5-star hotels. Owns Russian drugstore chain Doctor Stoletov. Collects the Impressionists; his most expensive painting is Dora Maar with Cat by Pablo Picasso, which he bought at Sotheby's in 2006 for \$95 million. (Excerpt from Forbes profile, March 2012)
<b>Political affiliation</b>	Georgian Dream ( <a href="http://www.georgiandream.ge">www.georgiandream.ge</a> ) is a union of several parties with diverse ideological orientations. Its official policy platform includes pledges to uphold multi-party democracy and Euro-Atlantic integration.
<b>Key assets</b>	100% of Cartu Bank (#9 by assets in Georgia), 21.7% of Progress Bank (small Georgian bank); Reportedly has divested most of his other assets (especially in Russia)
<b>Previous gov't posts</b>	None.
<b>Personal data</b>	Age: 56. Married. Four children. Place of birth: Chorvila, Soviet Union (now Georgia) French citizen (rival Saakashvili stripped him of Georgian citizenship in October 2011). Though legally he cannot become Prime Minister, Georgians consider this a non-issue and Saakashvili has said he will accept his candidacy.
<b>Education</b>	Ph.D. in Economics, Moscow State University of Railway Engineering Degree in Engineering & Economics, Tbilisi State University
<b>Web presence</b>	<a href="http://www.ivanishvilibidzina.com/eng">www.ivanishvilibidzina.com/eng</a> <a href="https://twitter.com/B_Ivanishvili">twitter.com/B_Ivanishvili</a> <a href="https://www.facebook.com/OfficialBIDZINAIVANISHVILI">www.facebook.com/OfficialBIDZINAIVANISHVILI</a> <a href="https://www.youtube.com/Ivanishviliofficial">www.youtube.com/Ivanishviliofficial</a>

**Analyst certification**

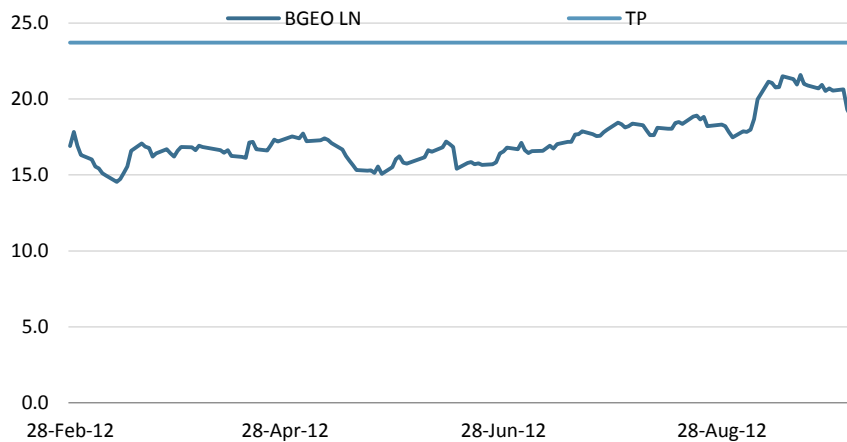
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**Bank of Georgia Holdings: Rating history**

Date	12M target price, USD	Market price, USD	Rating	Action
28-Feb-2012	23.7	14.2	BUY	Initiating
21-Mar-2012	23.7	16.9	BUY	Maintain
11-May-2012	23.7	17.3	BUY	Maintain
04-Oct-2012	23.7	18.9	BUY	Maintain

*Note: Bank of Georgia Holdings was covered by other Concorde Capital analysts from February 2012 to May 2012.  
Source: Concorde Capital*

**Bank of Georgia Holdings: Target prices vs. share performance, USD/share**



*Source: Bloomberg, Concorde Capital*

**Investment ratings**

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