

December 14, 2012

Bank of Georgia Holdings

Politically-based macro risks fade away

The 2013 state budget draft, submitted by the Georgian government in early December, indicates no changes in economic policy are being pursued by the new ruling party, thus significantly easing the macro risks highlighted by Bank of Georgia's CEO in his Nov. 1 conference call. With the key risks having faded away, we see no reason for Bank of Georgia Holdings to trade at a 50% discount to its FTSE-350 peers on P/E. We reiterate our positive outlook on BGEO stock, slightly upgrading our 12M target that prompts a 60% upside.

- BGEO stock has lost 20% in price since early October, thus significantly under-performing the FTSE-350 Banks Index (+10%), even though the bank reported strong 9M12 results. The sell-off was driven by uncertainty on political and economic policy in Georgia that emerged following the Oct. 1 elections, which resulted in the formation of a new government led by the former opposition leader who was very generous in pre-election social promises.
- The key uncertainty which came from the new government was whether it would pursue President Mikheil Saakashvili's strategy to stimulate economic growth via state investments into the economy. In the worst-case scenario, indicated by Bank of Georgia's CEO, 100% of the 2013 state budget spending would be social and recurring costs. The 2013 budget draft effectively eliminates that risk.
- While the new government appeared to be expectedly more populist (as it assumed a 31% yoy increase in social care expenditures in 2013), the budget's economy-focused spending did not change much, with just a 10% yoy decline planned. In particular, the draft foresees an 8% yoy decline in capital investments owing to halved spending on electricity (which doubled yoy in 2012 to invest in the Black Sea power grid and hydro power projects) and a decrease in some special projects initiated by the old government. On the other hand, investment into trade and tourism is earmarked to be 8% higher, into construction - 28% higher and into agriculture - 37% higher. Spending in the most important transportation sector (7% of total budget spending) remained flat yoy.
- Admitting that political uncertainty is still there (recall that the next presidential elections are scheduled for October 2013), we are encouraged that the first visible steps of Georgia's new government imply no radical changes in economic policy. We treat this as encouraging news for Bank of Georgia and supportive for the holding's plan to show double-digit annual growth in assets in the mid-term.
- With macro risks effectively lowered, we believe BGEO's 50% discount to its FTSE peers is no longer grounded. We are now more confident with our BUY recommendation for the stock.

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 Bloomberg BGEO LN

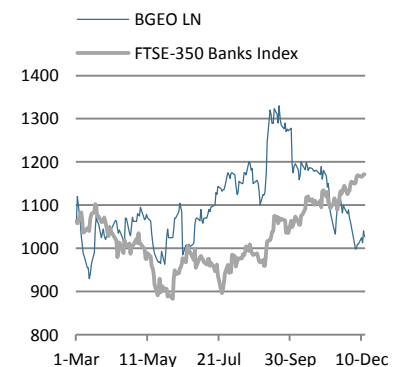
Recommendation	BUY
Price, USD*	16.7
Price, GBp*	1,040
12M target, USD	26.7
12M target, GBp	1,660
Upside	60%

No of shares, mln	35.9
Market Cap, USD mln*	601.1
Market Cap, GBp mln*	373.5
Performance since listing**	-2%
Historic high/low, GBp	1,330 / 930
ADT since listing, GBp mln	1.10
Free float, %	~95%

*Prices as of Dec. 13, 2012

** Listed on LSE main board since Feb-28, 2012

Performance, GBp / share



Source: Bloomberg

No reasons to question BGEO double-digit growth

Key risk for banking sector growth is eliminated

In his Nov. 1 conference call, the Bank of Georgia Holdings CEO stressed the importance of 2013 state budget parameters to derive an outlook for 2013 growth for both the bank and the economy. In particular, he mentioned a possible risk that a new populist government will stop all infrastructure projects and direct all budget expenditure to “social and recurring” payments.

Extract: Bank of Georgia CEO statement on loan book outlook for 2013

I'm looking for very simple thing. On the budget, what will be the portion of the infrastructure, what will portion is going to be social or recurring costs. So, if we see the recurring cost is 100% of the whole expenditure, we would lower our guidance for the loan book growth. ... So right now if we have something like I don't know 15% or 20% of the total budget of the infrastructure projects that we will, call it, stick to our kind of 20% target level [of loan book growth]

Source: Bloomberg

This risk hasn't materialized: despite a significant increase in social payments in the 2013 budget draft, infrastructure project investments are planned to decline only 8% yoy, and total expenditures into the economy will decline 10% yoy, mostly due to a high 2012 base. The key declining item is investment in the electricity sector (upon the completion of large projects such as hydro-power plant rehabilitation and the construction of a high-voltage line to Turkey). The most important direction of the government's latest investments, the transportation sector, remained unchanged, while state support of tourism and agri projects is targeted to increase 8% and 37%, respectively.

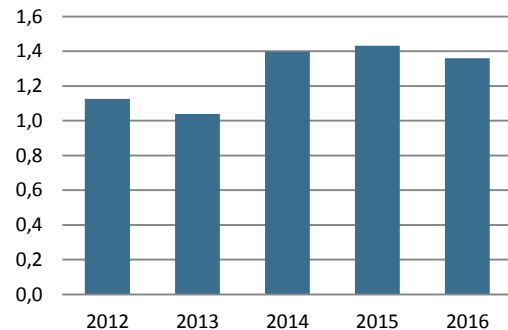
Moreover, the government's program assumes an increase of investment into infrastructure projects by 34% in 2014.

Directions of Georgia's government expenditure

	2011	2012 plan	2013 draft	yoy
Budget expenditure, GEL bln, including:	6.86	7.58	7.98	5%
Public sector	27%	27%	26%	0%
Social care	23%	23%	29%	31%
Health and environ't	4%	3%	3%	-20%
Security & defence	23%	20%	19%	-1%
Education & culture	10%	11%	10%	4%
Economy and infrastructure	14%	15%	13%	-10%
- transport	9%	7%	7%	0%
- agro	0%	2%	2%	37%
- tourism	1%	1%	1%	8%
- housing and utilities	1%	1%	1%	-6%
- fuel&energy	1%	1%	0%	-54%
- other	3%	3%	1%	-51%

Source: Parliament of Georgia, Government of Georgia, Concorde Capital research

CapEx projects initiated by government, GEL bln



In all, the worst-case scenario of Georgia's development – which we believe is implicitly priced in BGEO – has no grounds. We therefore believe the bank will continue demonstrating double-digit growth in its assets in the coming years.

Macro outlook is suitable for further banking sector growth

The macro indicators that the Georgian government assumed in its budgeting process suggest economic growth will continue:

- Real GDP is forecasted to grow 7% in both 2012 and 2013 (+7.4% in 1H12 and +7.1% in 10M12).
- Nominal GDP is forecasted to increase roughly 9% in 2012 and 10% in 2013
- State budget deficit to GDP is planned at 2.9% in 2013, vs. 3.5% in 2012E
- Public debt to GDP is planned to decline to 32.8% from 36.5% in 2012E

Georgia's macro and financial sector stats

	2007	2008	2009	2010	2011	1H12	2012E	2013P
GDP at current prices, GEL bln	16.99	17.07	17.99	20.74	24.34	12.93	26.60	29.3
yoy	23.2%	0.5%	5.4%	15.3%	17.4%	8.7%	9.3%	10.2%
GDP at current prices, USD bln	10.17	12.8	10.77	11.64	14.44	7.31	n/a	n/a
yoy	30.9%	25.9%	-15.9%	8.1%	24.1%	8.7%	n/a	n/a
Real growth	12.3%	2.3%	-3.8%	6.3%	7.2%	7.4%	7.0%	7.0%
Banking sector assets, GEL bln	7.21	8.87	8.29	10.56	12.68	13.10	14.10	n/a
yoy	70.5%	23.0%	-6.5%	27.4%	20.1%	16.8%	11.2%	n/a
% of GDP	42%	52%	46%	51%	52%	n/m	53%	n/a

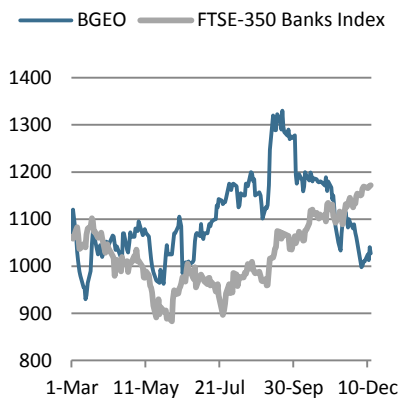
Source: GeoStat, NBG, Government of Georgia

An attractively priced stock

Having been the top-performer in the LSE-banking sector by end-September 2012, Bank of Georgia Holdings lost 20% in price afterwards, which was closely tied to political uncertainty in Georgia after the unexpected parliament election results on Oct. 1. Moreover, half of the price decline occurred in early November, following the bank's conference call that discussed 9M12 results (which were apparently strong), in which the CEO has expressed its uncertainty about future government policy, highlighting risk of possible populist moves and a scaling down of infrastructure projects.

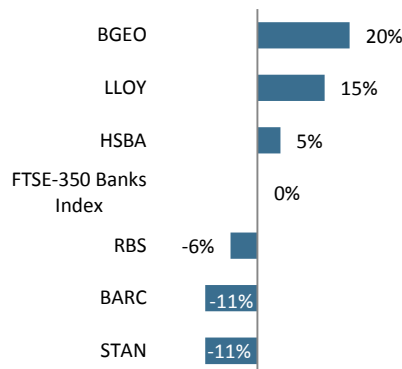
With the 2013 budget and government CapEx program on hand, we see the risk of declining investments into infrastructure and development completely fades away.

BGEO, GBp/share, vs. Index rebased



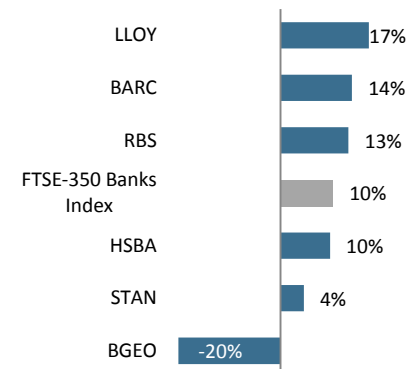
Source: Bloomberg

Performance, March*-September



* BGEO stock was listed on Feb 28, 2012;
Source: Bloomberg

Performance, October to date



Source: Bloomberg

With more certainty now that the bank will show double-digit growth in profit and assets in the next year, we believe the discount that the market is applying on BGEO's 2012 P/E is not grounded.

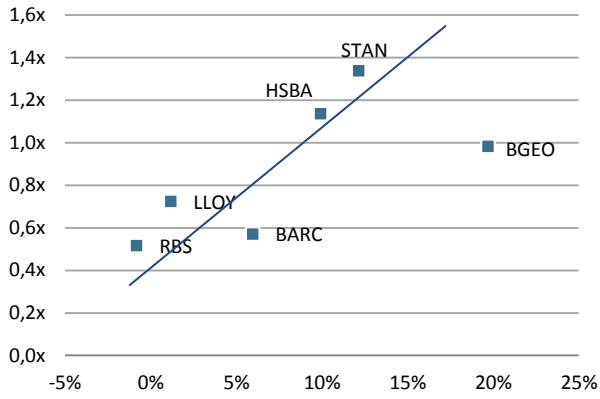
Comparison, BGEO vs. other FTSE-350 stocks

		P/E		P/B		ROE	
		2012E	2013E	2012E	2013E	2012E	2013E
Bank of Georgia	BGEO LN	5.9	4.6	0.9	0.8	19%	19%
Peer median		11.6	10.1	0.7	0.7	6%	8%
Premium/discount		-49%	-55%	31%	12%		
Peer data							
Standard Chartered	STAN LN	11.4	10.1	1.3	1.2	12%	13%
Barclays	BARC LN	7.3	6.5	0.6	0.5	6%	8%
HSBC Holdings	HSBA LN	11.8	10.4	1.1	1.1	10%	11%
Royal Bank of Scotland	RBS LN	-	6.1	0.5	0.5	-1%	4%
Lloyds Banking Group	LLOY LN	18.9	10.6	0.7	0.7	1%	5%

Source: Bloomberg, Concorde Capital research

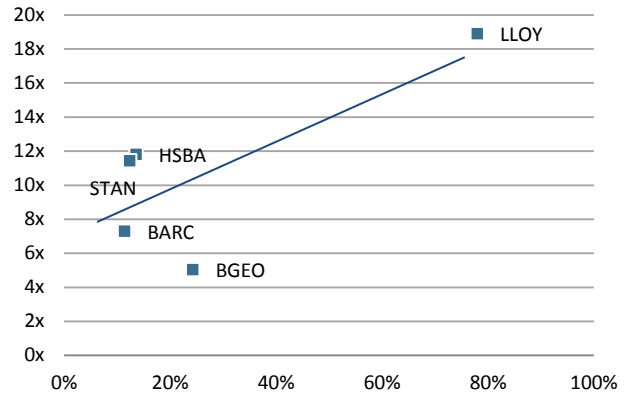
We reiterate our BUY recommendation on the stock, raising our 12M target to USD 26.7/share (GBp 1660), which suggests a 60% upside.

ROE 2012E vs. P/B 2012



Source: Bloomberg, Concorde Capital estimates

Earnings growth 2013/12 vs. P/E 2012



Source: Bloomberg, Concorde Capital estimates

Financials revision

Based on 9M12 results, which turned to be much better than we initially expected with most balance sheet parameters exceeding our previous end-2012 estimates, we upgrade our outlook for Bank of Georgia's financials, which causes an upgrade of the BGEO fair price estimate.

Bank of Georgia Holdings financial summary, USD mln (unless other specified)

	9M12	9M11	yoy	2012E			2013E		
				value	chg in estimate	yoy	value	chg in estimate	yoy
Net interest income	125	108	16%	159	+1%	14%	180	+3%	13%
Total revenue	223	192	16%	300	+6%	15%	339	+7%	13%
Total profit	80	61	31%	102	+1%	28%	132	+7%	29%
Basic EPS, USD	2.4	2.0	17%	3.0			3.9		
Assets	3,333	2,625	27%	3,440	+10%	23%	3840	+7%	12%
Net loans	1,846	1,542	20%	1,948	+8%	18%	2215	+5%	14%
Client deposits	1,620	1,301	25%	1,880	-1%	15%	2204	0%	17%
Equity	607	467	30%	634	0%	30%	753	+5%	19%
Basic BPS, USD	17.36	15.15	15%	18.12			21.51		19%
ROAE, annualized	19.4%	18.9%		19.0%	+0.9pp		19.0%	+0.8pp	
Net interest margin	7.8%	7.9%		7.8%	+0.6pp		7.6%	+0.7pp	
Cost / Income	45.2%	49.1%		45.7%	-3.8pp		45.5%	-2.2pp	

Source: Company data, Concorde Capital research

APPENDIX

Analyst certification

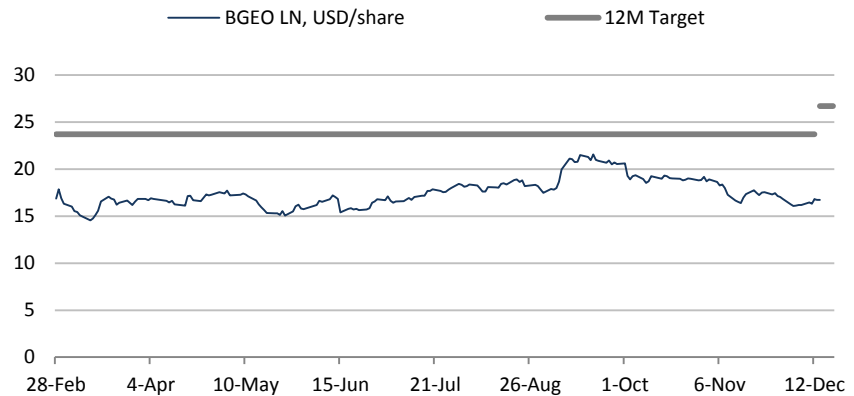
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Bank of Georgia Holdings: Rating history

Date	12M target price, USD	Market price, USD	Rating	Action
28-Feb-2012	23.7	16.9	BUY	Initiate
21-Mar-2012	23.7	16.8	BUY	Maintain
11-May-2012	23.7	17.1	BUY	Maintain
04-Oct-2012	23.7	19.3	BUY	Maintain
14-Dec-2012	26.7	16.7	BUY	Maintain

Source: Concorde Capital

BGEO LN: Market vs. target price, USD / 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.

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