

Bank of Georgia (BGEO.L)

Results: 1Q14 Initial Reaction – Miss Driven by Core Revenue

- **Citi's Take** — Bank of Georgia reported an IFRS 1Q net profit of GEL51.9m (+28% yoy, -3% qoq, -7% vs. Citi). The bottom line miss was driven by lower-than-anticipated core revenue.
- **Weaker Revenues** — Revenues amounted to GEL137.5m (+12% yoy, -5% qoq, -3% vs. Citi) in 1Q, missing our forecast due to weaker-than-expected net interest income (+10% yoy, -5% qoq, -6% vs. Citi) on the back of a more severe margin compression (down 57bps over the quarter to 49% in 1Q vs. our estimate of 5.2%) and weaker-than-expected fee income (-3% yoy, -14% qoq, -13% vs. Citi) which the bank attributed to ongoing client acquisition within the Express banking, higher plastic card fees and outsourcing of the bank's cash collection services. On the other hand, net insurance and healthcare results (+12% yoy, -6% qoq, +2% vs. Citi) came largely in line with our expectations and other operating income exceeded our estimate, driven by strong performance of the bank's real estate subsidiary.
- **In Line Costs & Provisions** — Costs (+10% yoy, -3% qoq, +1% vs. Citi) and provisions (-23% yoy, +33% qoq, -3% vs. Citi) came effectively in line with our expectations. Asset quality improved over the quarter with NPLs down 4% qoq in 1Q and the NPL ratio decreasing from 4.0% to 3.8% over the quarter. Provision coverage of NPLs stood at 92%.
- **Slow Start of the Year** — The loan book contracted 1% qoq and customer deposits were down 2% qoq bringing the loan-to-deposit ratio to 114% at the end of 1Q.
- **Management Call** — Friday, May 9 at 1pm (London), 8am (New York). Dial in details: +44 (0) 1452 555 566 (UK), +1 631 510 7498 (USA). Conference ID: 44156024. Replay: +44 (0) 1452 55 00 00 (international), 08717000145 (UK National), 0844 338 6600 (UK Local), 1866 247 4222 (USA). We expect investors to focus on margins and growth outlook given slow start of the year and updates on the bank's healthcare expansion strategy.
- **Implications** — We see some downside risks to our margin forecasts this year given ongoing pressure on loan yields and increased competition for credit. We plan to review our model following the conference call.

Buy	1
Price (08 May 14)	£26.73
Target price	£26.70
Expected share price return	-0.1%
Expected dividend yield	2.6%
Expected total return	2.5%
Market Cap	£907M
	US\$1,536M

Price Performance (RIC: BGEO.L, BB: BGEO LN)



Maria Semikhatova, CFA
+7-495-643-1462
maria.semikhatova@citi.com

Simon Nellis
+44-20-7986-4012
simon.nellis@citi.com

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Quarterly Financial Summary

Figure 1. Bank of Georgia – Quarterly Income Statement, 1Q13-1Q14 (GEL in thousand)

	1Q13	2Q13	3Q13	4Q13	1Q14	chg yoy	chg qoq	1Q14E	Act vs. Citi
Net interest income	72,596	77,898	80,035	83,567	79,704	10%	-5%	84,773	-6%
Net fee income	20,496	21,779	21,519	23,102	19,920	-3%	-14%	22,956	-13%
Net insurance & healthcare result	15,617	16,098	17,420	18,567	17,503	12%	-6%	17,179	2%
Net gain from trading and AFS securities	1,284	1,306	228	279	88	-93%	-68%	1,000	-91%
Net gains (losses) from revaluation of investment properties	0	4,842	2,868	2,078	0	na	na	1,000	na
Net gain from foreign currency	9,452	12,225	12,203	9,632	10,889	15%	13%	10,000	9%
Other operating income	3,531	5,552	4,065	7,215	9,376	166%	30%	4,500	108%
Revenue	122,976	139,700	138,338	144,440	137,480	12%	-5%	141,407	-3%
Labour cost	-32,501	-32,575	-34,361	-35,628	-35,808	10%	1%	-35,751	0%
General and administrative expense	-14,057	-15,707	-13,458	-17,142	-15,490	10%	-10%	-14,900	4%
Depreciation and amortisation	-6,593	-6,747	-6,550	-6,682	-6,874	4%	3%	-6,923	-1%
Other operating expense	-729	-711	-579	-1,545	-1,014	39%	-34%	-838	21%
Operating costs	-53,880	-55,740	-54,948	-60,997	-59,186	10%	-3%	-58,413	1%
Operating profit before provisions	69,096	83,960	83,390	83,443	78,294	13%	-6%	82,994	-6%
Cost of credit	-17,278	-18,984	-15,540	-10,000	-13,316	-23%	33%	-13,778	-3%
Operating profit	51,818	64,976	67,850	73,443	64,978	25%	-12%	69,217	-6%
Other non-operating income/loss, net	-1,365	-4,089	-1,419	-5,958	-1,120	-18%	-81%	-1,500	-25%
Profit before income tax	50,453	60,887	66,431	67,485	63,858	27%	-5%	67,717	-6%
Income tax	-8,456	-7,782	-7,834	-11,841	-10,194	21%	-14%	-10,158	0%
Net profit on continuing operations	41,997	53,105	58,597	55,644	53,664	28%	-4%	57,559	-7%
Net loss from discontinued operations	0	0	0	0	0	na	na	0	na
Minority interest	-1,400	-1,967	-2,487	-1,999	-1,739	24%	-13%	-2,000	-13%
Net profit	40,597	51,138	56,110	53,645	51,925	28%	-3%	55,559	-7%

Source: Company Reports and Citi Research Estimates

Figure 2. Bank of Georgia – Quarterly Key Balance Sheet Items, 1Q13-1Q14 (GEL in thousand)

	1Q13	2Q13	3Q13	4Q13	1Q14	chg yoy	chg qoq	1Q14E	Act vs. Citi
Loans and finance leases	2,954,724	3,122,916	3,300,682	3,522,915	3,489,252	18%	-1%	3,522,915	-1%
Assets	5,533,858	5,671,694	5,812,963	6,520,969	6,619,775	20%	2%	6,520,969	2%
Deposits	2,817,677	2,850,234	2,883,167	3,117,732	3,065,536	9%	-2%	3,180,087	-4%
Equity	1,057,345	1,048,592	1,104,702	1,182,540	1,218,601	15%	3%	1,238,099	-2%

Source: Company Reports and Citi Research Estimates

Figure 3. Bank of Georgia – Quarterly Key Ratios, 1Q13-1Q14 (Percent)

	1Q13	2Q13	3Q13	4Q13	1Q14	1Q14E
ROE	15.7%	19.4%	20.8%	18.8%	17.3%	18.4%
ROA	2.90%	3.65%	3.91%	3.48%	3.16%	3.41%
NIM on avg assets	5.2%	5.6%	5.6%	5.4%	4.9%	5.2%
Risk cost (Provision charge/Avg Loans)	2.2%	2.4%	1.9%	1.1%	1.5%	1.5%
Fee/Revenue	17%	16%	16%	16%	14%	16%
Cost/Income	44%	40%	40%	42%	43%	41%
Cost/Avg Assets	3.85%	3.98%	3.83%	3.96%	3.60%	3.58%
Loans/Assets	53%	55%	57%	54%	53%	54%
Loans/Deposits	105%	110%	114%	113%	114%	111%
Equity/Assets	19.1%	18.5%	19.0%	18.1%	18.4%	19.0%
Effective tax rate	17%	13%	12%	18%	16%	15%
Tier 1 ratio, Basel	23.2%	22.9%	23.7%	23.0%	23.8%	na
CAR, Basel	28.2%	27.8%	28.6%	27.1%	27.8%	na
CAR, NBG	17.1%	16.3%	16.6%	15.4%	16.4%	na
NPL ratio	4.3%	4.1%	4.2%	4.0%	3.8%	4.1%
Provision coverage of NPLs	86.5%	89.1%	86.2%	83.8%	92.0%	89.9%

Source: Company Reports and Citi Research Estimates

Bank of Georgia

Valuation

We value Bank of Georgia's insurance and healthcare segment separately, given its growing contribution. Applying average 2015E P/E multiples for different segments, based on consensus forecasts for GEM peers.

We continue to value the rest of the bank using a standard warranted equity valuation. We assume a sustainable ROE of 20.6% (excluding the insurance and healthcare business), a cost of equity of 15.0%, and a long-term growth rate of 5%. This delivers a target price-to-book multiple of 1.56x, which, when applied to our 2016E estimate of book value per share and discounted back to 12 months from today, delivers a target valuation of GEL 57.31 per share.

At current exchange rates, the sum of the above valuations translates to a rounded target price of £26.70.

Risks

Georgia's recent history has been marked by revolution, civil war and conflict with Russia. These shocks have buffeted the economy and the banking sector. The fallout from these shocks is high dollarization of the economy, a volatile growth path and elevated through-the-cycle cost of risk. Following the parliamentary elections last October, policy uncertainty and postponed government spending led to a slowdown in the economy. Whereas the end of the transition period is expected to support the recovery the economy remains vulnerable to political changes as well as external shocks. A higher or lower risk cost or pace of growth than we assume in our model, and consequently better- or worse-than-expected margins and/or returns, could cause the shares to deviate significantly from our target price. Other risks relate to the bank's success in executing its healthcare expansion strategy and disposing of non-core businesses.

Appendix A-1

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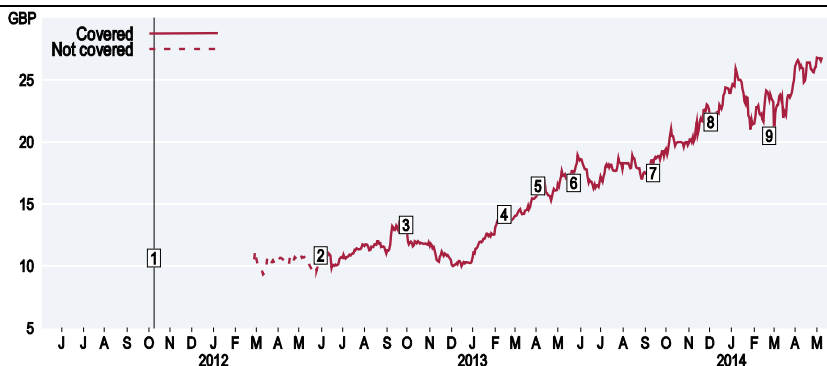
Bank of Georgia (BGEO.L)

Ratings and Target Price History

Fundamental Research

Analyst: Maria Semikhatova, CFA

Covered since April 3 2013



Date	Rating	Target Price	Closing Price
1 8-Oct-11	Stock rating system changed		
2 31-May-12	*1	*13.20	10.25
3 28-Sep-12	1	*15.00	12.72

* Indicates change

Date	Rating	Target Price	Closing Price
4 14-Feb-13	*2	15.00	13.94
5 3-Apr-13	*1	*18.50	15.90
6 23-May-13	1	*20.20	17.46

Date	Rating	Target Price	Closing Price
7 12-Sep-13	*2	*20.70	18.27
8 3-Dec-13	2	*24.50	21.70
9 24-Feb-14	*1	*26.70	23.43

Rating/target price changes above reflect Eastern Standard Time

Bank of Georgia (BGEO.L)

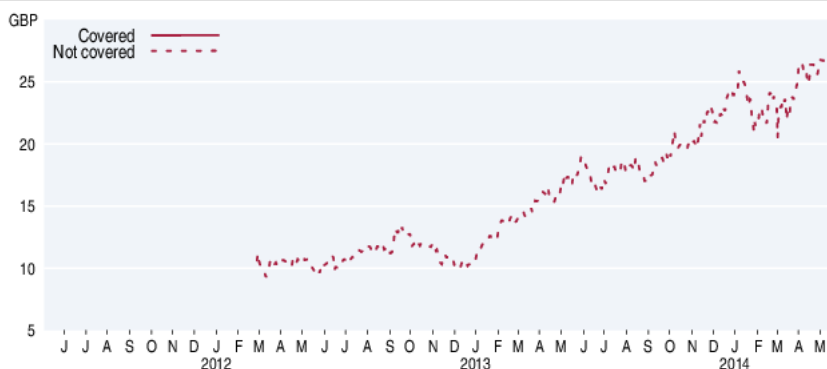
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Maria Semikhatova, CFA

Covered since April 3 2013



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12 Month Rating			Relative Rating		
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49%	40%	12%	1%	98%	1%
55%	53%	45%	58%	53%	42%

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