

Bank of Georgia Long-Term Rating Raised To 'BB-' On Bank Criteria Change; Outlook Stable

Overview

- Following a review of Bank of Georgia (BoG) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have raised our long-term rating on BoG to 'BB-' from 'B' and affirmed our 'B' short-term rating. The outlook is stable.
- Our ratings on BoG reflect our 'bb-' anchor for a commercial bank operating in Georgia, as well as our view of BoG's strong business position, moderate capital and earnings, moderate risk position, average funding, and adequate liquidity compared with other banks with similar industry risk.
- The stable outlook reflects our expectation that BoG's improving asset quality and earnings will continue to balance its moderate capitalization and risk position. We believe BoG's credit quality will remain unchanged over the next year.

Rating Action

As previously announced, on Dec. 16, 2011, Standard & Poor's Ratings Services raised its long-term counterparty credit rating on the Bank of Georgia (BoG) to 'BB-' from 'B'. The 'B' short-term counterparty credit rating was affirmed. The outlook is stable.

Rationale

Standard & Poor's bases its ratings on BoG on the bank's "strong" business position, "moderate" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is 'bb-'.

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Publication Date

Dec. 16, 2011

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Under our bank criteria, we use the Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Georgia is 'bb-'.

Georgia's economic risk score is '7' reflecting its narrow economic base, low prosperity, and slow progress on structural reforms, which somewhat constrain economic resilience. However, Georgian banks benefit from the government's political commitment to market-oriented policies and structural reform. On the external side, Georgia has moderate levels of government debt.

Georgia's industry risk score is '8', which is underpinned by regulation that is in line with international standards, sound governance, and good transparency. The risk appetite of the country's banks, however, has been high, as can be seen in their fast asset growth before the 2008-2009 financial market crisis and their significant exposure to risky real estate and construction sectors. We assess Georgia's systemwide funding as "very high risk", reflecting a high level of net external funding.

BoG has a "strong" business position in the Georgian context. It is the largest bank in Georgia and had a 34.7% share of the sector's loans and 34.5% of deposits at Nov. 30, 2011. BoG is a universal bank with a broad mix of business lines and is present across Georgia. BoG benefits from a strong management team, which, since 2004, has focused on upgrading the bank's organization, infrastructure, and risk management capabilities. Management has international experience and is professional, in our view.

We consider BoG's capital and earnings "moderate". Our estimated risk-adjusted capital (RAC) ratio, before adjustments for diversification, was in the range of 6.5% to 7.0% based on data as of Dec. 31, 2010. Our RAC calculation differs from reported capital ratios for regulatory purposes, owing to the higher risk weightings we apply to assets based in Georgia. The bank's retained earnings are enough to sustain capitalization during periods of moderate risk asset growth, in our view. The projected RAC ratio, before adjustments for diversification, is expected to remain in the range of 6.5% to 7.0% over the next 18 months, despite anticipated risk asset growth. The Bank for International Settlements' Tier I capital adequacy ratio reached 18.0% at midyear 2011, well in excess of regulatory minimum levels.

Profitability has normalized since heavy losses in 2009, with BoG posting a profit of Georgian lari (GEL) 83 million (about \$50 million) in 2010 and a further GEL64 million for the first half of 2011. BoG benefits from strong interest margins exceeding 7%, complemented by relatively good fee and commission income. Credit costs reduced materially to 2% of loans in 2010 and less than 1% of loans in first-half 2011 from a high of more than 6% in 2009. Given the upturn in business activity and a moderate return to credit growth, we expect BoG's operating income to continue improving in 2012.

BoG's risk position is "moderate" relative to peers', in our opinion. Given the concentration of its activities in Georgia, BoG's asset quality is highly vulnerable to the performance of the narrow domestic economy, accentuated through high amounts of foreign currency-denominated lending and expected fast credit growth. BoG's loss experience is in line with peers'. Loan portfolio indicators worsened in 2009, after several years of robust credit growth, following the conflict with Russia the previous year and with the impact of economic recession. This was consistent with the Georgian banking sector as a whole. Asset quality deterioration has started to ease since the second half of 2009, with nonperforming loans representing less than 4% of customer loans by June 30, 2011. BoG's reserves have remained comfortable, covering problem loans by more than 100%, providing a buffer in

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the event of further asset quality deterioration. Loan concentrations are not very high, as the top 20 exposures are only 136% of the bank's adjusted total equity, which is below the average in the region.

BoG's funding is "average" and its liquidity is "adequate", in our view. Liquidity is supported by BoG's diversified funding base, substantial funding support from multilateral organizations, and low short-term refinancing needs. The bank's deposit base increased significantly in 2010, although it has demonstrated volatility in the past. Central bank funding is also available when needed, as demonstrated during the financial market crisis.

Liquidity ratios are comfortable, but will likely keep tightening as leverage increases with loan growth. The loan-to-deposit ratio is about 100%, and the leverage ratio is currently an adequate 58%. BoG still retains a strong level of liquid assets. Wholesale funding is mostly composed of multilateral funds.

Outlook

The stable outlook reflects our view that BoG's improving asset quality and earnings balances its moderate level of capitalization and overall risk position. Upward rating movement will depend on the sovereign rating being raised, as well as on BoG's ability to strengthen its capitalization (with the projected RAC ratio exceeding 10%) or improve its risk position through sustainable, moderate loan growth and continued credit cost reduction. A sustained improvement in the economic risks in Georgia, which in turn has a positive effect on BoG and the Georgian banking system, could also lead to positive rating action on BoG, again subject to a sovereign upgrade.

If BoG's asset quality and credit-related losses again deteriorated, its financial performance and ability could come under pressure, leading us to consider a negative rating action. More specifically, the ratings could be lowered if aggressive loan growth undermined asset quality, with credit costs exceeding 2% of loans, leading us to reassess BoG's risk position as "weak"; or if the projected RAC ratio fell below 5%.

Ratings Score Snapshot

Issuer Credit Rating	BB-
SACP	bb-
Anchor	bb-
Business Position	Strong (+1)
Capital and Earnings	Moderate (0)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011

Ratings List

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Bank of Georgia		
Counterparty Credit Rating	BB-/Stable/B	B/Positive/B
Senior Unsecured	BB-	B
Certificate Of Deposit	BB-/B	B/B
BG Finance B.V.		
Senior Unsecured	BB-	B

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