STANDARD & POOR'S RATINGS SERVICES
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Bank of Georgia

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Table Of Contents

Bank of Georgia

SACP	bb-

+

Support	0

+

Additional Factors	0

Anchor	bb-	
Business Position	Strong	+1
Capital and Earnings	Adequate	0
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Adequate	

GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BB-/Stable/B

Major Rating Factors

Strengths:	Weaknesses:
• Largest domestic bank in Georgia, with a superior distribution network. • Strong management team, focused on strengthening the bank's organization and risk management framework. • Adequate liquidity, supported by a diversified funding base, substantial funding support from multilateral organizations, and low short-term refinancing needs.	• High political, economic, and operating risks inherent to operating in Georgia. • Recent economic slowdown that could undermine asset quality and capitalization. • Vulnerability of loan portfolio quality to high amounts of foreign-currency-denominated lending.

Outlook: Stable

Standard & Poor's Ratings Services' stable outlook on Bank of Georgia (BoG) reflects its view that the bank's good earnings and capitalization balance its high credit risk. Upward rating movement will depend on an upgrade of the Government of Georgia (BB-/Stable/B), as well as on BoG's ability to strengthen its capitalization, with the projected risk-adjusted capital (RAC) ratio exceeding 10%, or improve its risk position through sustainable, moderate loan growth and continued credit cost reduction. A sustained reduction of economic risks in Georgia, which in turn has a positive effect on BoG and the Georgian banking system, could also lead to a positive rating action on BoG, subject to a sovereign upgrade.

If BoG's asset quality and credit-related losses were to deteriorate, its financial performance could come under pressure, leading us to consider a negative rating action. More specifically, we could lower the ratings if aggressive loan growth undermined asset quality, with credit costs exceeding 3% of loans, leading us to reassess BoG's risk position as "weak," or if the projected RAC ratio fell below 5%. We would also take a negative rating action on the bank following a similar action on the sovereign.

Rationale

The starting point for our ratings on BoG is its 'bb-' anchor, which is based on our view of the banking system in Georgia. We consider BoG to have a "strong" business position, "adequate" capital and earnings, a "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile is 'bb-'.

Anchor: 'bb-' for banks operating only in Georgia

Under our bank criteria, we use our Banking Industry Country Risk Assessment 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 the country's narrow economic base, low prosperity, and slow progress in structural reforms, which somewhat constrain economic resilience. However, Georgian banks benefit from the government's political commitment to market-oriented policies and structural reform. Externally, 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 the rapid growth of their assets before the 2008-2009 financial market crisis and their significant exposure to the risky real estate and construction sectors. We assess Georgia's systemwide funding as having "extremely high risk," reflecting a high level of net external funding.

Table 1

Bank of Georgia Key Figures

		--Year-end Dec. 31--			
(Mil. GEL)	**2014***	**2013**	**2012**	**2011**	**2010**
Adjusted assets	6,688.1	6,384.1	5,589.3	4,573.8	3,891.9

Table 1

Bank of Georgia Key Figures (cont.)					
Customer loans (gross)	3,956.2	3,652.4	3,215.9	2,731.5	2,542.2
Adjusted common equity	1,257.3	1,146.4	1,035.2	730.7	574.9
Operating revenues	437.0	546.2	498.8	445.9	346.9
Noninterest expenses	196.6	221.8	218.5	231.2	200.7
Core earnings	176.2	224.8	199.4	169.8	82.7

Note: All figures are adjusted by Standard & Poor's. *Data as of Sept. 30. GEL--Georgian lari.

Business position: Largest bank in Georgia

BoG has a "strong" business position in the Georgian context. It benefits from a leading franchise in the domestic market, with a 31.6% share of the sector's loans and 27.5% share of deposits as of Sept. 30, 2014. 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.

BoG offers corporate and investment banking and leasing services, and holds a strong position in the domestic mortgage and consumer banking segments, with a retail base of up to 1.4 million clients as of Sept. 30, 2014. The bank is also active in the insurance and health care sectors in Georgia through a dedicated subsidiary. In addition, the bank offers wealth management services. BoG's franchise is supported by one of the largest and most rapidly expanded networks in the country, including 217 branches, 83 express branches, 521 ATMs, mobile and Internet banking services, and a call center, as of end-September 2014.

BoG's business strategy of strong franchise growth has moderated with the recent economic slowdown. Accordingly, we expect loan growth to remain moderately high in the next few years. Long-term growth prospects remain strong, however, because the uptake of banking services in the country is increasing.

BoG's current focus is on its home market. Consequently, the bank has been exiting its foreign operations and does not envisage any further investments for the time being. BoG acquired two small banks in Ukraine and Belarus in 2007 and 2008, respectively. It divested its subsidiary in Ukraine in 2011 due to the difficult operating environment there, and it may consider exiting its Belarusian operations in the medium term due to its focus in Georgia. The current weight of BoG's international subsidiaries is insignificant. The Belarusian banking operations accounted for under 5% of assets as of end-September 2014.

Table 2

Bank of Georgia Business Position				
	--Year-end Dec. 31--			
(%)	**2013**	**2012**	**2011**	**2010**
Total revenues from business line (mil. GEL)	546.2	498.8	448.8	346.9
Commercial banking/total revenues from business line	29.7	31.0	30.2	40.8
Retail banking/total revenues from business line	48.9	49.4	47.0	46.8
Commercial & retail banking/total revenues from business line	78.6	80.4	77.2	87.6
Insurance activities/total revenues from business line	10.7	11.0	6.8	6.0
Asset management/total revenues from business line	1.8	2.8	1.6	3.5

Table 2

Bank of Georgia Business Position (cont.)				
Other revenues/total revenues from business line	8.8	5.8	14.4	2.9
Return on equity	18.2	19.3	18.4	13.5

Note: All figures are adjusted by Standard & Poor's. GEL--Georgian lari.

Capital and earnings: Earnings are sufficient to sustain capitalization during periods of moderate risk-asset growth

We consider BoG's capital and earnings to be "adequate." Our estimated RAC ratio, before adjustments for diversification, was 10.6% based on data as of Dec. 31, 2013. Our RAC calculation differs from reported capital ratios for regulatory purposes, owing to the higher risk weights 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.

However, we project that the RAC ratio, before adjustments for diversification, will decrease to 9.5%-10.0% over the next 12-18 months, alongside the anticipated moderate risk-asset growth. We assume loan growth of some 15% per year over the next few years, largely sustained high interest margins, credit costs of about 1.5%–2.0% of total loans, and dividends of 25%-40%.

We consider the Georgian regulator's approach to calculating capital adequacy to be conservative, insofar as the central bank requires a 175% risk weight for foreign-currency loans and banks to maintain a minimum total capital adequacy ratio of 12%. BoG's stand-alone regulatory Tier I ratio stood at 14.5% as of Sept. 2014, compared with the consolidated ratio of 22.7%, as investments in subsidiaries (more than 50%) are deducted from capital. The Basel II stand-alone total capital ratio was 14.2% at the same date.

In February 2012, BoG's capital was supported by the conversion into shares of part of a $25 million convertible loan from the International Finance Corporation and European Bank for Reconstruction and Development. In 2006, BoG's shares, in the form of global depository receipts, were sold on the London Stock Exchange in line with a $150 million IPO to institutional investors. BoG's international listing has strengthened its capacity to access capital, although, for the short term, we believe that ongoing capital market turmoil could limit management's ability to raise new equity. The bank's dividend payout ratio was 33% in 2013. We expect the dividend payout ratio to be between 25% and 40% over the next few years.

Profitability has normalized since heavy losses in 2009, with BoG posting a profit of GEL214 million ($123 million) in 2013. Earnings continued strengthening in the first half of 2014, despite elevated credit losses. BoG benefits from strong interest margins of about 7%-8%, complemented by relatively good fee and commission income. Despite reducing interest rates, we expect high margins to sustain over the next few years given the better utilization of earning assets and reducing funding costs. Credit costs are rising from less than 1% of loans in 2011, reaching 1.5% and 1.8% in 2012 and 2013, respectively, due to the recent economic slowdown. We expect credit costs to remain close to 2013 levels over the next two years, and not to increase to peak levels of more than 6% seen in 2009. Given the moderation of business activity, balanced by good margins, we expect BoG's operating income to stay strong in 2014.

BoG has relatively diversified earnings, with retail and corporate activities contributing equally to preprovision operating income. Net interest earnings, derived mainly from customer lending, are the main source of revenue, contributing about 60% on average to the total during the past five years.

Despite an expected reduction of asset growth, net interest earnings should remain strong, with margins staying comparatively wide, given the credit risks inherent in Georgia, as well as BoG's lending mix and large portion of lower cost, fixed-rate funding.

BoG receives a substantial amount of fees and commissions, thanks to selective charges on its banking activities, brokerage and advisory services, and currency operations. Market-related earnings are also important, and stem from client-led foreign-exchange transactions.

BoG continues focusing on cost containment and efficiency enhancement measures, including through further information technology improvements, to reduce the expenditure base. Noninterest expenses still represented a high 3.8% of average assets in 2013 and in the first three quarters of 2014 (annualized), but reduced from 4.2% in 2012. Management still has latitude to cut costs in the future.

Table 3

Bank of Georgia Capital And Earnings

		--Year-end Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Tier 1 capital ratio	22.7	23.0	22.2	19.9	17.5
S&P RAC ratio before diversification	N.M.	10.6	10.7	9.0	6.9
S&P RAC ratio after diversification	N.M.	8.6	8.5	7.1	5.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	56.5	57.6	57.3	52.5	62.4
Fee income/operating revenues	16.8	15.9	17.5	16.9	18.3
Market-sensitive income/operating revenues	8.0	10.3	10.1	20.2	8.2
Noninterest expenses/operating revenues	45.0	40.6	43.8	51.8	57.9
Preprovision operating income/average assets	4.8	5.3	5.4	5.0	4.2
Core earnings/average managed assets	3.5	3.7	3.8	3.9	2.4

Note: All figures are adjusted by Standard & Poor's. *Data as of Sept. 30. RAC--Risk-adjusted capital. N.M.--Not meaningful.

Table 4

Bank of Georgia Risk-Adjusted Capital Framework Data

(Mil. GEL)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	1,466	0	0	1,477	101
Institutions	549	0	0	624	114
Corporate	2,089	0	0	3,524	169
Retail	1,706	0	0	2,077	122
Of which mortgage	444	0	0	284	64
Securitization§	0	0	0	0	0
Other assets	1,002	0	0	2,036	203
Total credit risk	6,812	0	0	9,738	143

Table 4

Bank of Georgia Risk-Adjusted Capital Framework Data (cont.)					
Market risk					
Equity in the banking book†	5	0	0	51	971
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	51	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	0	--	1,024	--
(Mil. GEL)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification	--	0	--	10,813	100
Total Diversification/Concentration Adjustments	--	--	--	2,462	23
RWA after diversification	--	0	--	13,276	123
(Mil. GEL)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments	--	1,170	23.0	1,146	10.6
Capital ratio after adjustments‡	--	1,170	23.0	1,146	8.6

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. GEL--Georgian lari. Sources: Company data as of Dec. 31, 2013, Standard & Poor's.

Risk position: Credit loss history has been in line with the sector average

BoG's risk position is "moderate" relative to its 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 domestic peers' with credit costs of 1.8% in 2013 and closer to 2% (annualized) in the third quarter of 2014. Asset quality deterioration has eased since the second half of 2009, with nonperforming loans representing 3.7% of customer loans on Sept. 30, 2014. Good reserve coverage and a policy of rapid write-offs have aided this speedy recovery. Loan portfolio indicators worsened in 2009, after several years of robust credit growth, following the country's conflict with Russia the previous year and because of the impact of economic recession.

BoG's reserves have remained comfortable, covering problem loans by over 90%, providing a buffer in the event of further asset quality deterioration. Loan concentrations are below the average for the region. We expect the moderate pressure on asset quality to continue over the next couple of years, given the economic slowdown in Georgia. The bank foreclosed properties representing up to 5% of gross loans as of end-September 2014, as a result of problem loans written off in the past.

We view positively the reduction of the bank's credit growth appetite to match the more benign economic environment. High foreign-currency exposure increases the loan portfolio's vulnerability, in our view. BoG's enhanced credit risk framework and procedures, paired with adequate diversification in the loan book and provisioning on problem loans, partly mitigate the potential downside for credit quality, in our view.

Credit quality is also exposed to foreign-currency risks, with foreign-currency loans accounting for approximately 69% of lending in line with the high dollarization of the domestic economy. The overall diversification in BoG's loan portfolio, on the other hand, is adequate. Lending to private companies represented 58% of the loan book at year-end 2013, followed by households (39%) and state-owned entities (3%). The corporate portfolio appears well diversified, with only moderate exposure to particularly vulnerable segments, such as the construction industry (6.5% of the loan book). The 20 largest corporate clients represented less than 1X adjusted total equity at year-end 2013, comparing well with international peers'. Apart from residential mortgage lending, which made up 12.4% of total loans, BoG's retail banking activities include consumer finance (18.3%) and microenterprise loans (15.7%).

BoG's securities portfolio represented 8% of its consolidated assets as of year-end 2013, consisting mainly of local government paper. Market risk exposure, concentrated in foreign currency and interest rate mismatches, is limited and adequately monitored. Foreign exchange trading is mainly client-led, although BoG is also a market-maker in U.S. dollar-Georgian lari transactions and, as such, it trades on its own account. Open foreign currency positions are limited to a maximum of 20% of BoG's regulatory capital, and managed using foreign exchange contracts. The bank's actual open foreign currency position is lower, however, at approximately 2% of capital as of year-end 2013. Exposure to interest rate risk is reduced by the prevalence of fixed-rate assets and liabilities.

Table 5

Bank of Georgia Risk Position

		--Year-end Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Growth in customer loans	11.1	13.6	17.7	7.4	37.3
Total diversification adjustment / S&P RWA before diversification	N.M.	22.8	26.6	27.5	25.8
Total managed assets/adjusted common equity (x)	5.4	5.7	5.5	6.4	7.0
New loan loss provisions/average customer loans	1.5	1.8	1.5	0.8	2.2
Net charge-offs/average customer loans	(0.7)	0.7	1.3	0.8	1.6
Gross nonperforming assets/customer loans + other real estate owned	N/A	4.8	6.0	3.6	4.7
Loan loss reserves/gross nonperforming assets	N/A	68.8	57.5	117.1	147.4

Note: All figures are adjusted by Standard & Poor's. *Data as of Sept. 30. RWA--Risk-weighted assets. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: A strong level of liquid assets, with good access to various sources of funding

We view BoG's funding as "average" and its liquidity as "adequate." 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 has increased significantly since 2010, although it has demonstrated volatility in the past. Central bank funding is also available when needed, as shown during the financial market crisis.

Liquidity ratios are comfortable, but have tightened as leverage increases with loan growth. The loan-to-deposit ratio was 114% at year-end 2013, and the bank continues to retain a strong level of liquid assets. Wholesale funding is mostly composed of multilateral funds.

With no major repayments due until 2017, the stable funding ratio was also comfortable at 119% at year-end 2013. BoG's funding base is vulnerable to depositor and investor sentiment, as shown by the spike in deposit withdrawals during the crisis. Moreover, liquidity management is still constrained by the lack of a credible domestic market for alternative liquid instruments. BoG's liquidity remains adequate overall, however, supported by a relatively diverse and stable funding profile, funding support from multilateral organizations, low refinancing needs, and an adequate liquid asset cushion.

The rapid increase in customer deposits means that deposits met about 64% of BoG's funding needs as of the third quarter of 2014, half coming from retail deposits. Corporate deposits accounted for 39% of the deposit base on that date, and showed low concentration by client groups (the 20 largest deposits comprised about one quarter of client deposits). More than half of customer deposits were more stable time deposits.

Given deposit volatility, BoG has aimed to support liquidity through alternative sources, with material term funds from multilateral and development organizations. After repaying its US$200 million Eurobond in 2012, BoG issued Eurobonds of US$250 million (with an additional US$150 million in 2013) maturing in 2017. We consider international borrowings from multilateral organizations to be a relatively stable source of funding, in addition to customer deposits. Refinancing risks are low for the short term, with the largest debt obligations falling due in 2017.

Table 6

Bank of Georgia Funding And Liquidity

		--Year-end Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Core deposits/funding base	60.0	62.1	60.3	69.9	63.3
Customer loans (net)/customer deposits	124.1	113.6	118.4	102.4	118.0
Long term funding ratio	76.9	89.0	86.0	94.0	94.7
Stable funding ratio	96.6	118.5	113.6	122.3	N/A
Short-term wholesale funding/funding base	28.7	13.5	17.5	7.3	6.3
Broad liquid assets/short-term wholesale funding (x)	1.1	2.6	2.0	4.5	N/A
Net broad liquid assets/short-term customer deposits	3.7	38.0	32.0	36.0	N/A
Short-term wholesale funding/total wholesale funding	71.7	35.7	44.0	24.1	17.2
Narrow liquid assets/3-month wholesale funding (x)	1.1	3.9	3.1	6.4	N/A

Note: All figures are adjusted by Standard & Poor's. *Data as of Sept. 30. N/A--Not applicable.

External support: No notches of uplift to the stand-alone credit profile

The long-term issuer credit rating on BoG is at the same level as the stand-alone credit profile, and in line with the long-term foreign currency sovereign credit rating. As a result, we don't incorporate any extraordinary support to reflect the bank's high systemic importance to Georgia, whose government we classify as supportive under our methodology.

Additional rating factors: None

No other factors affect the rating.

Related Criteria And Research

Related criteria

- Group Rating Methodology, May 7, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related research

- Georgia 'BB-/B' Foreign And Local Currency Ratings Affirmed; Outlook Stable, Nov. 14, 2014

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	**7**	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	**bb-**	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 18, 2014)

Bank of Georgia		
Counterparty Credit Rating		BB-/Stable/B
S&P Maalot (Israel) National Scale		ilA/Stable/--
Senior Unsecured		BB-
Counterparty Credit Ratings History		
16-Dec-2011		BB-/Stable/B
26-Aug-2011		B/Positive/B
26-Sep-2008		B/Stable/B
10-Feb-2012	*S&P Maalot (Israel) National Scale*	ilA/Stable/--
26-Aug-2011		NR/--/--
26-Aug-2011		ilBBB+/Positive/--
Sovereign Rating		
Georgia (Government of)		BB-/Stable/B

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable

Ratings Detail (As Of December 18, 2014) (cont.)

across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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