

Kyklos Capital

OUTLOOK: The Case for Georgia

"Whoever does not miss the Soviet Union has no heart. Whoever wants it back has no brain."

Vladimir Putin

Kyklos has recently increased its holdings in companies from the country of Georgia, once part of the Soviet Union and the birthplace of Joseph Stalin, located between Russia and Turkey, which is to say, in a rough neighborhood. The investment opportunity is compelling for multiple reasons, however.

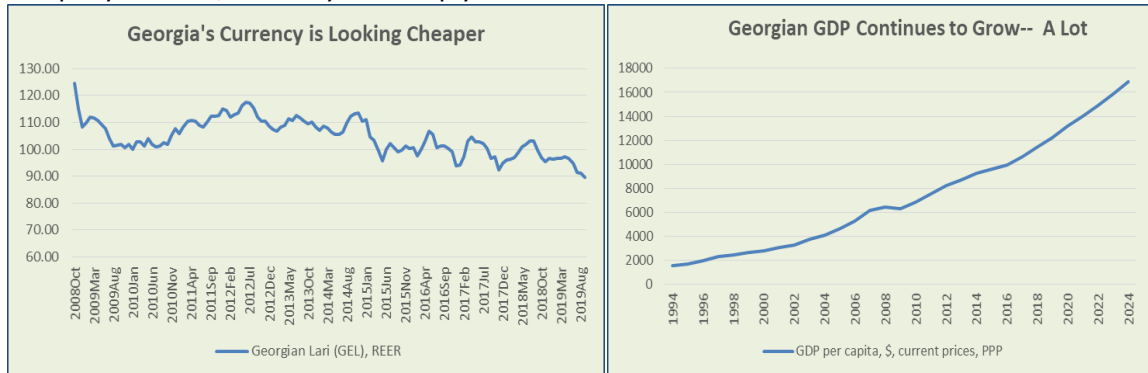
First, Georgia features world-class political and economic governance, largely thanks to its post-Soviet leadership, which was early in aligning itself with Western institutions and the private sector. It ranks near the top for global Ease of Doing Business (#6) and Economic Freedom (#16), and in corruption measures like Business Bribery (#27). Like many countries this year, Georgia's currency and equities were hit by political demonstrations starting in June, but the demonstrators were largely reacting against Russian influence and perceived corruption, underlining the strong consensus for free markets. In October the U.S. Congress voted to "support Georgia's sovereignty, independence, and territorial integrity", among other exceptional gestures, probably to counter potential Russian pressure.

Second, development opportunities for Georgian companies are big. The current GDP of about \$10,000 per person (PPP) has multiplied some five times since the post-Soviet chaos, but is still less than one-half that of Russia or Turkey, and it grows at a pretty good clip of +4%-6% annually with a lot more to go (below). Unlike many Frontier countries, Georgia has few major state-owned financial or industrial firms, so the private-sector listed companies that we own are profiting from the rapidly expanding economy. Georgians abroad, of whom there are many, confirm this healthy picture with their checkbooks, having about doubled the remittances that they send home in the last three years.

Third, the investment case is backed up by the numbers. The currency's trade-weighted valuation has steadily declined (below), making Georgia's exports and tourism more attractive to foreign customers. Finances are in solid shape, with reasonable debt levels, an improving current account-- thanks to lower trade deficits-- and positive moves by debt rating agencies. Imports are dominated by capital goods such as machinery and autos rather than consumer goods, which is positive for future economic growth. Meanwhile, the two banks that Kyklos owns, Bank of Georgia and TBC Group, are valued by the market at PE ratios below 5 and price-

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to-book ratios barely above 1, despite more than double the profitability of the global banks index, at about 25% return on equity. We think these banks, as well as the listed private equity company we own, are likely to multiply in value over time.



Risks for investors in Georgia include Russia, which occupies Georgian territory and keeps its tanks ready to roll, Georgian domestic politics, with its recent demonstrations and allegations of corruption, and oligarch-style issues such as a renewed banking scandal regarding decade-old events. We think that the recent share price weaknesses has as much to do with recent cash-raising by international Frontier fund managers to cover heavy redemptions by their investors, since the London listings of our Georgian stocks are convenient for selling as well as buying. Adding it all up, Georgia's risks seem to us to be lower overall compared with most Frontier countries, and we have bet accordingly.

Charlie Gushee
November 1, 2019

Interesting October Reading

CAMBODIA/ How to get a European passport for a hefty check:

<https://www.reuters.com/investigates/special-report/cambodia-hunsen-wealth/?mod=djem> Frontiers

Oxford sees improved risk/reward in Africa: <http://resources.oxfordeconomics.com/africa-risk-reward-index-2019?source=wsjfm&mod=djem> Frontiers

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Steve Eisman gives the ABCs on why European banks struggle:

<https://www.youtube.com/watch?v=XDQYMFkbtvY>

How African countries got their names. Hint: one was a misprint:

<https://qz.com/africa/1722919/how-many-african-countries-got-their-names/>

A bitter blog on Mongolian Stock Exchange interventions:

<https://www.linkedin.com/pulse/absurdity-still-prevails-mongolian-stock-exchange-pascal-vinais/?trackingId=im14bzEKoJOI4WMcKesFDw%3D%3D>

A site of live recordings from protests worldwide: <http://citiesandmemory.com/protest/>

Longtime owner of Western eyeballs on China, Louis-Vincent Gave, on how bonds are the biggest bubble, and China looks ok: <https://themarket.ch/interview/gave-the-bond-market-is-the-biggest-bubble-of-our-lifetime-ld.945?mktcid=sms&mktcval=LinkedIn>

Nigerian shades of Zimbabwe: ½ of the budget is funded by the printing press.

<https://businessday.ng/exclusives/article/broke-fg-taps-lender-of-last-resort-for-biggest-bailout-since-1999/>

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