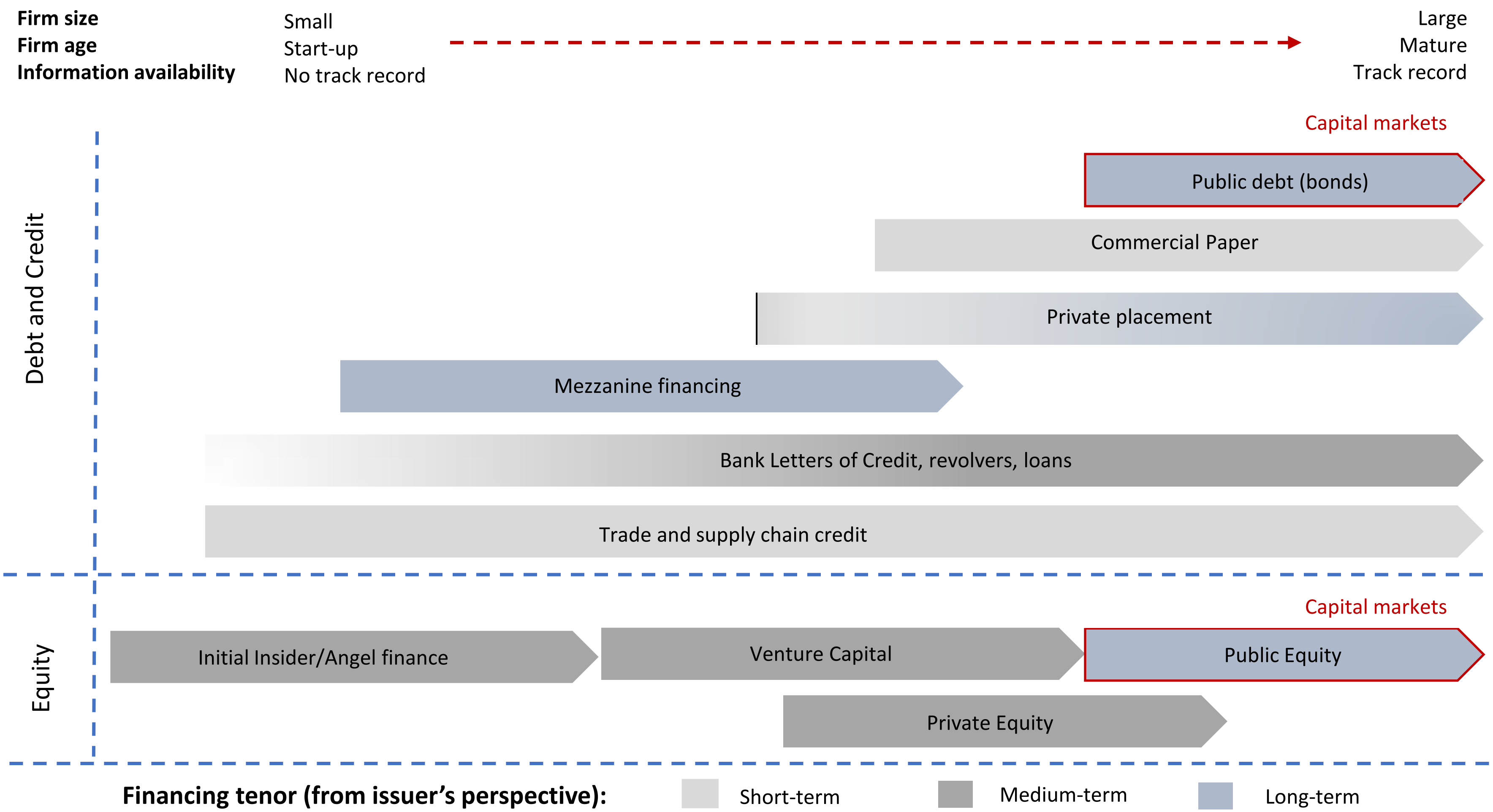
GEORGIAN STOCK EXCHANGE

Georgian Capital Market Development

George Paresishvili, CEO

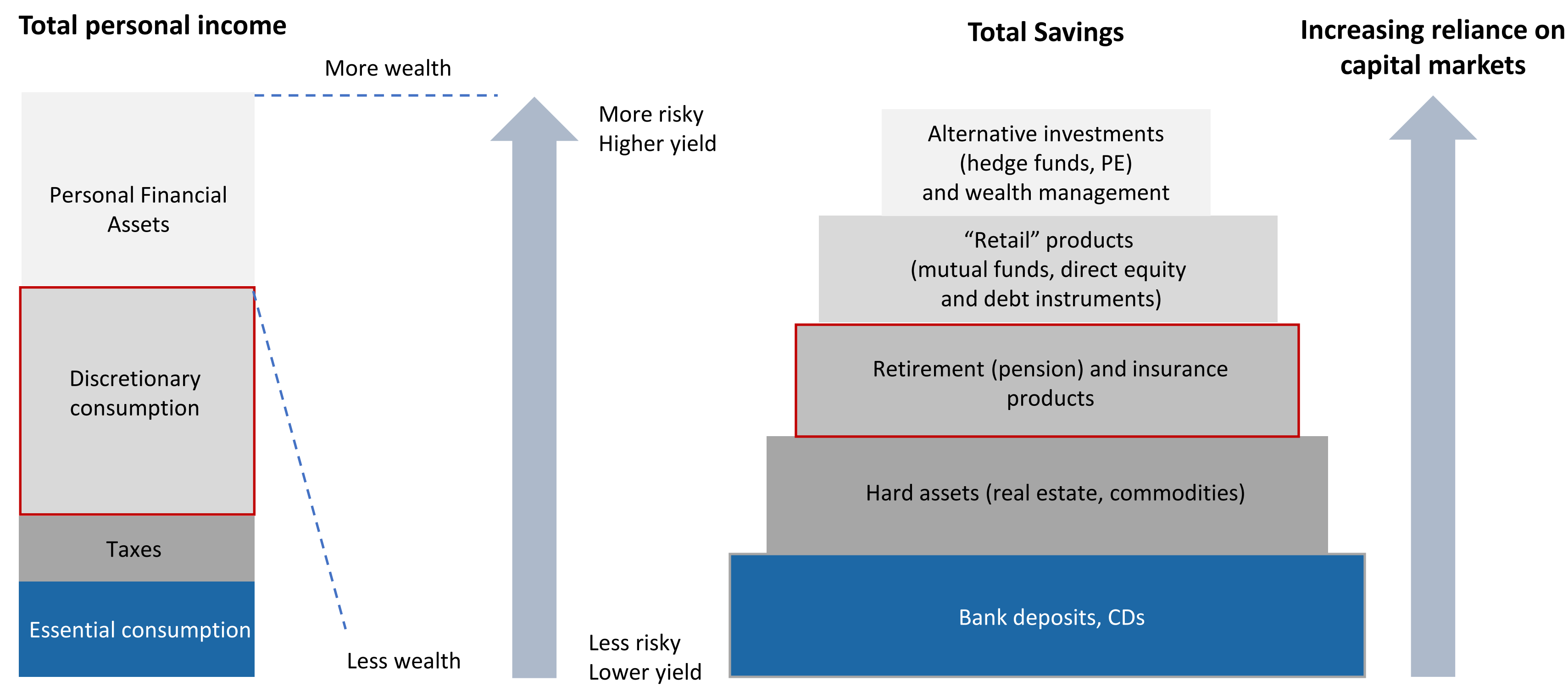
21 June 2017

Evolution of corporate financing



Source: World Economic Forum, Corporate Bond Market 2015

Evolution of personal savings and investments



Increased personal income allows for accumulation of personal financial assets

As wealth increases, saver tries to diversify savings to those that can provide increased yields and to protect from future income shocks

This leads to purchases of retirement and insurance products; savers start to participate in retail capital market products and alternative investments

This leads to increased need for capital markets

Source: World Economic Forum, Corporate Bond Market 2015

Corporate bond market structure

Financial instrument/Capital

Issuers

- Financial institutions
- Quasi-sovereigns
- Non-financial institutions (corporates)

Financial intermediaries

- Broker-dealers
- Banks
- Asset Managers

Investors

- Asset managers (mutual funds, hedge funds)
- Asset owners (insurers, pension funds, banks, governments, agencies)

Market intermediaries and infrastructure providers

Information and rating providers

- Market benchmarks and indices
- Data distribution vendors
- Risk assessment providers (rating agencies)

Infrastructure providers

- Exchanges
- Depositories/Custodians
- Clearing and settlement

Market enablers

Regulation and legislation

- Corporate governance and investor protection
- Accounting and reporting standards
- Securities market regulation
- Industry regulation

Social and macroeconomic policies

- Pension/retirement policies
- Tax regimes
- Education (financial)

Source: Oliver Wyman, World Economic Forum, Corporate Bond Market 2015

Current stage of capital market development

- Measuring progress
- Equities and bonds

Sequence of corporate bond market (players)

	Stage 1: Establishing basic bond market processes	Stage 2: Enhance infrastructure and processes for corporate bond market	Stage 3: Widening the issuer and investor base	Stage 4: Improving liquidity and risk management	Stage 5: Expand integration with international markets
Issuer	• Government/Quasi	• Government/Quasi • Financial Institutions • Largest corporates	• Government/Quasi • Financial Institutions • Medium/large corporates	• Government/Quasi • Financial Institutions • Wider range of local corporates	• Government/Quasi • Financial Institutions • Wider range of local corporates (including foreign)
Investors	• Foreign investors (limited) • Banks • Domestic Institutional (limited)	• Foreign investors • Banks	• Foreign investors • Banks • Domestic institutional • Sophisticated domestic retail	• Foreign investors • Banks • Domestic institutional • Retail investors • Alternative investors	• Foreign investors • Banks • Domestic institutional • Retail investors • Alternative investors

Market characteristics -Types of market participants

Source: Oliver Wyman, World Economic Forum, Corporate Bond Market 2015, modified by GSE

Sequence of corporate bond market (policy)

	Stage 1: Establishing basic bond market processes	**Stage 2:** Enhance infrastructure and processes for corporate bond market	**Stage 3:** Widening the issuer and investor base	**Stage 4:** Improving liquidity and risk management	**Stage 5:** Expand integration with international markets
Policy actions					
Market and product development	• Establish basic market infrastructure • Establish benchmark curve through government bond issuances • Develop institutional investors	• Introduce corporate bond issuances • Establish wholesale credit market • Establish credit rating system	• Reduce issuance costs and accelerate issuance timeline • Promote growth of asset management industry • Promote investor relations culture and ability to manage compliance with covenants	• More sophisticated financial instruments • Enhance investor and issuer awareness • Development of a domestic swap curves • Ability for repos -securities borrowing and lending	• Regulatory approval processes for international issuers • Linkages of domestic market with international markets (linking of exchanges, collateral management, and clearing systems)
Risk management	• Establish regulatory body to govern securities markets	• Restrict permissible investment for institutional investors • Establish market standards (accounting, corporate governance) and regulations (insider trading laws)	• More relaxed investment criteria for institutional investors (more non-government securities) • Better reflect international standards in regulations • Legal system and enforcement	• Continue to relax investment criteria for institutional investors (allow to invest in other types of assets) • Refine regulations to adapt to more complicated market structure and instruments	• Potential treaties to facilitate and govern cross-border capital flows • Extend capital account liberalization

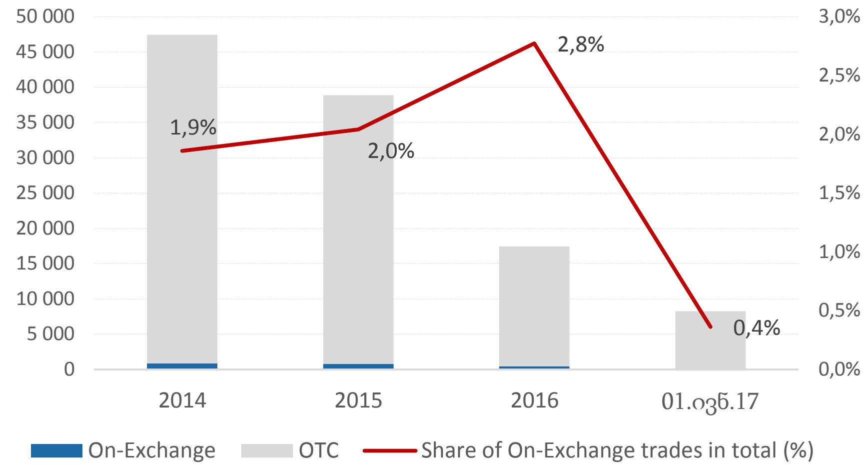
Source: Oliver Wyman, World Economic Forum, Corporate Bond Market 2015

Equity instruments

Equity market remains underdeveloped:

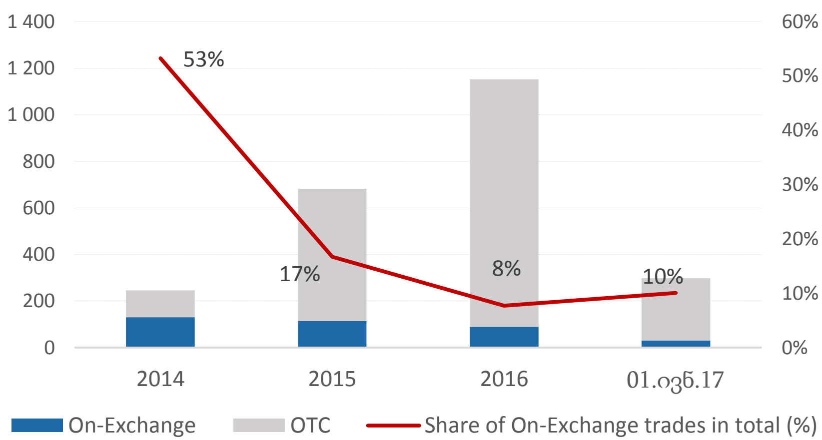
- company owners are reluctant to give up their stake and seek other sources of financing
- cost of equity is too high
- and equities are riskier investment for mainstream investors (banks, pension funds, retail clients)

Equities, value traded, thousand GEL



Source: GSE

Equities, number of trades



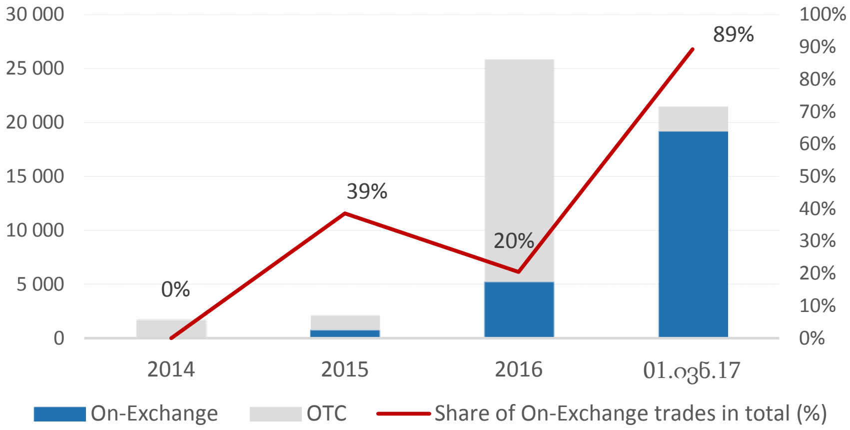
Source: GSE

Number of equity issuers	2014	2015	2016	1 June, 2017
On-Exchange	6	5	4	5
OTC	33	36	34	22

Source: GSE

Bond instruments

Bonds, value traded, thousand GEL



Source: GSE

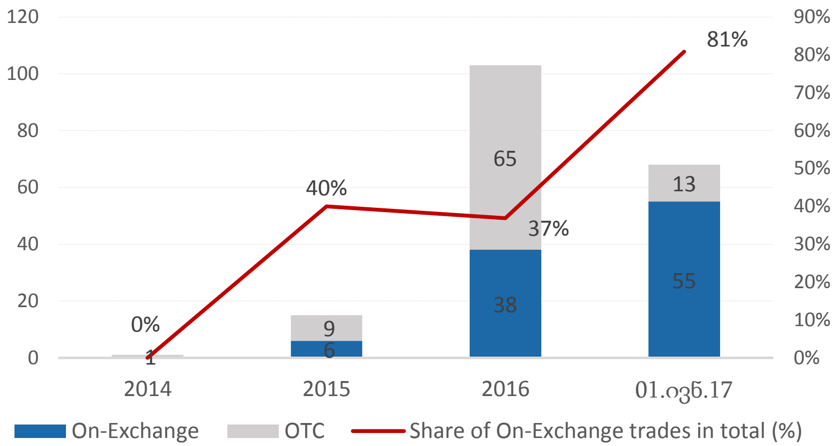
Bond market is currently more attractive for both issuers and investors:

- bonds are similar to bank loans
- cost of debt is lower
- bonds are less risky investment for mainstream investors (banks, pension funds, retail clients).
- some bonds can be used by banks for getting refinancing loans from NBG which makes them attractive liquidity instrument

Number of bond issuers	2014	2015	2016	1 June, 2017
On-Exchange	0	3	4	4
OTC	1	3	4	3

Source: GSE

Bonds, number of trades



Source: GSE

Recent bond issuances: Eurobonds

Eurobonds

	GOGC	GoG	GR	BGEO	BOG	EBRD
Issue Size	250 mln	500 mln	500 mln	350 mln	500 mln	120 mln
Currency	USD	USD	USD	USD	GEL	GEL
Issue Date	26-Apr-16	12-Apr-11	5-Jul-12	26-Jul-16	1-Jun-17	24-Apr-17
Maturity Date	26-Apr-21	12-Apr-21	11-Jul-22	26-Jul-23	1-Jun-20	24-Apr-22
Tenor	5 Y	10 Y	10 Y	7 Y	3 Y	5 Y
Coupon	Fixed	Fixed	Fixed	Fixed	Fixed	Floating
Issuer rating Fitch/S&P/Moody's	BB-/B+/-	BB-/BB-/Ba3	B+/B+/-	BB-/-/B1	BB-/-/Ba3	AAA
Coupon Rate	6.75%	6.88%	7.75%	6.0%	11.0%	3 m GEL/CD/ NBG
Listed on	LSE	LSE	LSE	LSE	LSE	LSE

Source: Bloomberg

Recent bond issuances: corporate

Selected corporate issues

	GLC	m2 Real Estate	Nikora	GWP	EVEX
Issue Size	10 mln	25 mln	5 mln	30 mln	15 mln
Currency	USD	USD	USD	GEL	USD
Issue Date	22-Sep-14	7-Oct-16	18-Mar-16	6-Dec-16	19-May-15
Maturity Date	22-Sep-17	7-Oct-19	18-Mar-18	6-Dec-21	19-May-17
Tenor	3 Y	3 Y	2 Y	5 Y	2 Y
Coupon	Fixed	Fixed	Fixed	Floating	Fixed
Issuer rating Fitch/S&P/Moody's	-	-	-	BB-	-
Coupon Rate	8.75%	7.5%	11.0%	NBG Ref Rate + 3.5%	9.5%
Listed on	GSE	GSE	GSE	-	GSE

Source: GSE

Recent bond issuances: International

IFIs issues

	EBRD	EBRD	ADB	ADB	IFC	BSTDB	BSTDB
Issue Size	25 mln	107 mln	64 mln	100 mln	108.3 mln	48 mln	60 mln
Currency	GEL	GEL	GEL	GEL	GEL	GEL	GEL
Issue Date	13-Feb-15	17-Jun-16	6-Jul-16	19-Feb-15	1-Jun-17	5-Nov-15	4-Aug-16
Maturity Date	13-Feb-18	11-Jun-21	6-Jul-19	15-Feb-18	1-Jun-20	1-Nov-18	29-Jul-21
Tenor	3 Y	5 Y	3 Y	3 Y	3 Y	3 Y	5 Y
Coupon	Floating	Floating	Floating	Floating	Fixed	Floating	Floating
Issuer rating Fitch/S&P/Moody's	AAA	AAA	AAA	AAA	AAA	A2/A-	A2/A-
Coupon Rate	3 m GEL/CD/ NBG + 20bps	3 m GEL/CD/ NBG	3 m GEL/CD/ NBG + 20bps	3 m GEL/CD/ NBG	7.99%	3 m GEL/CD/ NBG	3 m GEL/CD/ NBG
Listed on	-	GSE	-	-	-	-	-

Government of Georgia

GEL denominated government bonds: GEL 2.2 billion outstanding

1, 2 and 5-year Treasury Notes

10-year Treasury Bonds

- Owned primarily by Georgian banks and large non-resident (7% of total) institutional clients
- Used by banks primarily for liquidity management purposes
- Traded by primary dealers (banks) over the counter

Source: GSE, MOF

Issuing bonds in foreign vs domestic currency

	International	Domestic
Market:	International	Domestic
Currency:	Foreign “hard” currency	Local currency “floating” rate
Investor perspective	+ Lower inflation risk + Lower currency risk (for foreign investors) + Greater information availability + Access to a wide set of issuers + Falls under international regulation which many cases is more investor friendly – Greater currency risk (for certain domestic issuers – those with limited international trade operations)	+ Exposure to issuers who cannot access international markets + No asset-liability currency mismatch (for domestic investors) – Greater currency risk (for foreign investors) – Higher inflation risk – Size of domestic issuances may not be sufficiently large for foreign investors to dedicate resources
Issuer perspective	+ Access to a wide set of investors, hence issuances are likely to be fully subscribed + Lower cost of financing (vs less liquid domestic market) - Asset-liability currency mismatch - More burdensome documentation process including requirements for internationally-recognized credit rating - More expensive issuance costs and longer execution time frame (avg. 10-12 weeks), particularly for first-time issuers	+ No asset-liability currency mismatch + Typically quicker execution (average 3-4 weeks) + Fewer financial disclosure/compliance requirements – Limited set of investors – Higher chances that issuances will not be fully subscribed – Higher cost of financing as investors demand greater risk and liquidity premium

Source: World Economic Forum, Corporate Bond Market 2015

Key challenges: issuers and investors

Factors impacting market	Key challenges for issuers	Key challenges for investors
Ability to access	• Length and costly issuance process • Burdensome corporate governance or reporting standards (companies either not sophisticated enough to comply with standards or reluctant to do so) • Burdensome regulatory approval process	• Market not included in global benchmark indices • Difficulty for foreign investors to get to scale due to capacity and remoteness of the market • Underdeveloped asset management industry • Restrictions on investment criteria
Risk of market framework	• Concerns that issuing corporate bonds to banks will cannibalize the issuer's bank lending rates	• Volatile macroeconomic and political conditions (or history of) • Weak regulatory/legal framework • Inconsistent application or enforcement of the legal and regulatory framework • History of unexpected changes to policies • Limited standards around corporate governance
Relative costs and returns	• High cost of capital relative to other sources of debt financing, such as bank loans • High premium on primary market issuances due to perceived risks of the market framework or lack of secondary market liquidity	• Insufficient number and size of issuances to meet investor requirements • Limited secondary market liquidity making it hard for investors to exit their positions without causing disruption to the market price
Ability to match supply and demand	• Lack of intermediaries for market-making • Lengthy transaction and execution time	• Limited financial reporting • Low transparency of market information • Limited credibility of credit ratings • Limited secondary market activity from which to base pricing of primary and secondary market offerings • Underdeveloped financial intermediation industry

Source: World Economic Forum, Corporate Bond Market 2015

Regulation and legislation

- Corporate governance and investor protection
- Accounting and reporting standards
- Securities market regulation

Regulation and legislation update

Law on Entrepreneurs and Securities Market Law

New standards on:
- Independent board members and audit committee
- Disclosure requirements for related party transactions and management compensation
- Protection of minority investors

Corporate Governance, Accounting and Reporting Standards

- Corporate Governance standards are improving
- Companies are required to publish annual reports
- Annual reports need to be prepared according to IFRS
- Capital markets development strategy approved by the government in 2016

SARAS and GSE: cooperation

SERVICE FOR ACCOUNTING, REPORTING AND AUDITING SUPERVISION

Is developing online reporting platform for financial statements

Currently working on Memorandum of Understanding regarding cooperation related to reporting of listed companies

Our common universe of companies:
Public Interest Entity which are Accountable Enterprises listed on Stock Exchange

Currently working on integration of GSE reporting platform for Accountable Enterprises listed on Stock Exchange into the SARAS reporting platform.

The aim is to create One Reporting Window for companies and simplify information submission

GEORGIAN STOCK EXCHANGE

Has developed sector specific/standard reporting platform for companies in A and B listing in 12 sectors /subsectors:

- Financial Statements
- Ratios
- Operational data (disclosures)

Held consultations with 24 companies in these sectors. Have developed forms from investor perspective

Disclosure and Corporate Governance support the development of capital markets and increase market liquidity

- Corporate governance disclosure =reduced risks = **increased market valuation and investor confidence**
- Uniform accounting standards improves comparability of companies across markets and countries = the use of information less costly for investors = **lower cost of capital**

Social and macroeconomic policies

- Pension and retirement policies
- Tax regimes

Pension Reform: Pillar II System

Pension reform highlights

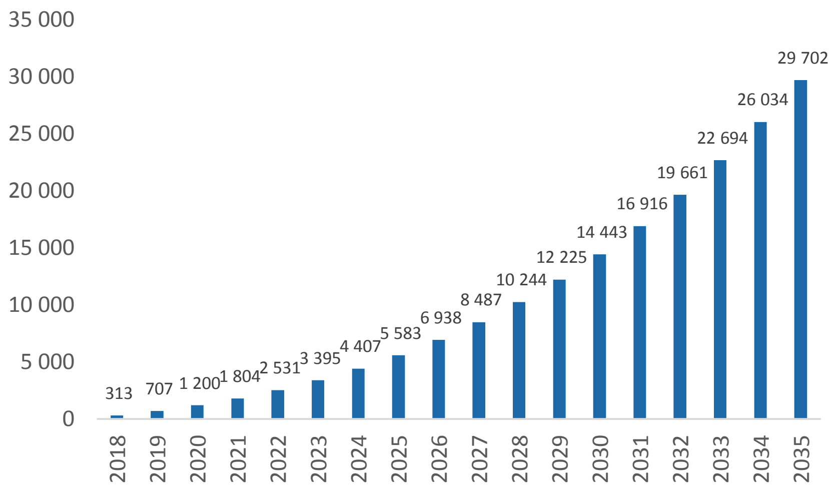
Pension reform design (current proposal):

- Employees contribute 2% from their monthly salary to their individual pension account
- Employers match this contribution by another 2%
- Government matches with additional 2% contribution

Thus total monthly contribution will be 6% of employee's gross salary

Source: Ministry of Economy and Sustainable Development of Georgia

Estimated accumulation of pension fund assets, mln Lari



Significant funding source for domestic economy through debt and equity issuances (long-term GEL funding)

Source: Ministry of Finance of Georgia, Ministry of Economy and Sustainable Development

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Information and rating providers

- Risk assessment providers (rating agencies)

Credit rating

How much difference a credit rating can make for a bond's price/yield during the placement or after?

At least 50 basis points which translates into GEL 500k annual savings for a GEL 100 million bond issue

To compare: cost of obtaining and maintaining credit rating is USD 25 - 50k annually

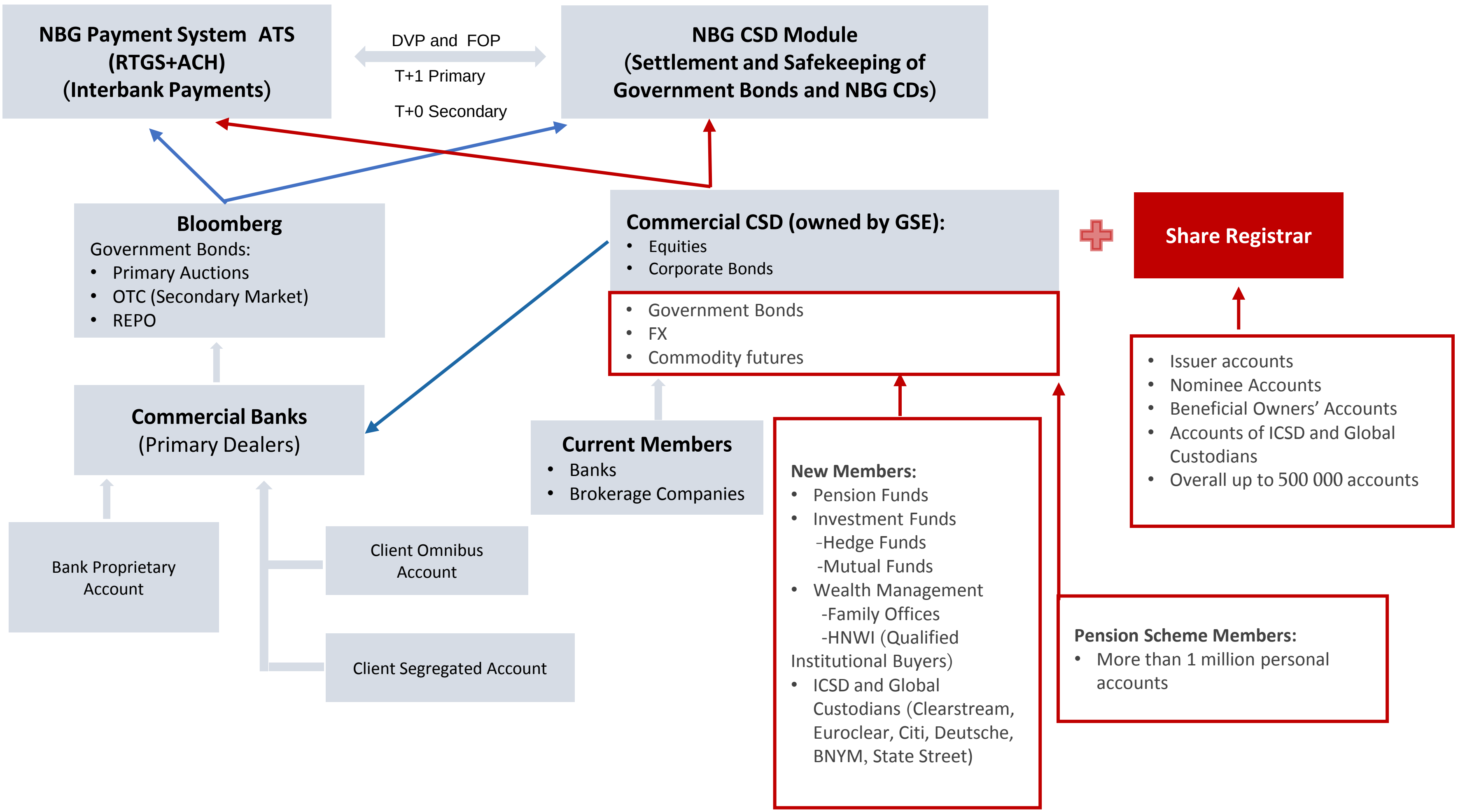
GSE organized two roadshows for Fitch Ratings. Met with approximately 20 large Georgian companies.

Some of them already hired Fitch and got rated (GWP: BB-, Silknet: B+, more in the pipeline)

Infrastructure providers

- Exchanges
- Depositories/Custodians
- Clearing and settlement system

New clearing and settlement system (1)



New clearing and settlement system (2)

New system capabilities

Georgian Central Securities Depositary (GCSD)	Share Registrar "Kavkasreestri"
• Clearing and settlement of on-Exchange trades • OTC trades clearing and settlement • IPOs • REPOs (among GSE members and with NBG) • Margin Calculation • Guarantee Fund • Collateral Management • Securities Lending / Borrowing • Corporate Actions (Dividends, Coupon Payments, Stock Splits, Shareholders Meetings, etc.) • Tax services for investors • Custody and safekeeping of local and foreign securities	• Keeping records of securities of beneficial and nominal owners • Transfer of securities, collateral and blocking • Account/turnover statements, issuing ownership/title certificates • Holding and servicing individual accounts of pensioners • Recording Individual units of pension and mutual funds • Calculation of fund Net Asset Value for Asset Managers and Administrators • Reliable and independent source for market value of securities for Brokers and Asset Managers

New clearing and settlement system (3)

New system advantages

Advantage	Impact
Clearing and settlement in Central Bank's money	Higher speed, lower operational risks and costs
Better access to secondary market by institutional investors (including pension and mutual funds)	Institutional investors will be able to trade and hold government securities though GSE and GCSD, thus increasing liquidity of government bond market
NBG and commercial banks will be able to conduct REPO operations using corporate bonds	Corporate bonds will be accepted as collateral electronically, directly from market participants (banks, brokers, pension funds) in semi-automated manner
Reduced counterparty risk	Counterparty risk reduces for OTC trades as settlements will take place in DVP (Delivery vs Payment) mode
Access to foreign investors	Foreign investors will be able to hold Georgian corporate securities through Clearstream. This will increase demand for Georgian securities and market liquidity

Issuing corporate bonds

- Is it the right time for Georgian companies to issue corporate bonds and in which currency?
- Is it better to issue a bond or take a bank loan?

Interest rates on bank deposits dropped, making investments in bonds far more attractive

Leading Georgian companies have matured for a public issue (good corporate governance, competent management, IFRS accounting and so forth), especially in GEL

Banks are willing to buy corporate bonds, subject to NBG's new REPO scheme eligibility

Cost of obtaining international credit rating became more affordable

International investors are increasingly seeking higher yield in prolonged historically low interest rate environment

Get ready for pension reform to tap much larger and more liquid markets (larger issues, longer term, GEL denominated, lower rates)

Thank you!