



TBC CAPITAL

Alcoholic Beverages:

Heritage of splendor

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EXECUTIVE SUMMARY

Wine production is gaining momentum in Georgia, underpinned by the growing harvest and demand from international markets. The volume of produced wine is expected to surge by 28% YoY in 2019, reaching 21.7mln decalitres, with total estimated value of GEL 1bn. Rtveli broke the 30-year record two times in a row. The amount of processed grapes increased by 9% YoY to 271 thousand tons in 2019. We expect the wine production to increase at 5.1% CAGR till 2025, reaching the output of 381 thousand tons.

Georgia lags behind other winemaking countries in average productivity. At 5.1 tons per hectare, grapes yield is three times lower in the country compared to other top exporters. However, the yield equals 8.5 tons/ha on average for the large-scale producers. We believe that the consolidation of sparse vineyard plots, modernization and the renewal of the vine stock will positively impact the productivity.

The wine and spirits market remains largely fragmented. Currently there are 420 companies producing the wine, most of them small-scale. Currently, one third of wine production in Georgia is informal, coming from mostly scarce vineyards owned by small-scale farmers. We see the potential for consolidation on market for achieving the economies of scale.

IRR for production of different grape varieties ranges between 14% and 18%. The project payback period varies from seven to nine years. State subsidized credit program can further boost these returns.

We believe the share of informal production will decrease in future. The growing urbanization and decline in self-subsistent agriculture will underpin the process. Alternatively, former informal wine producers might increasingly act as grapes suppliers for the formal producers, or organize into enterprises themselves.

Georgia is among the top 20 wine exporting countries globally and foreign demand is the main driver of the sector. Wine exports increased by 13% YoY in 2019 and constituted USD 223mln, capturing 5.9% of Georgia's total export value. The share of export in wine turnover is estimated at over 80% for 2019.

We expect the proportion of produced wine to shift further in favor of red wines, as target exporting markets prefer Georgian dry and semi-sweet red wines. Currently accounting for over 60% of total production, the wines made of Rkatsiteli are mostly consumed within the country, or used for spirits production, while wines made solely or partially from Saperavi grapes constitute 73% of exports. We further believe Georgian PDO wines to have a great export potential for high-end market.

We see the need and potential in export diversification. Of Georgia's total wine exports in 2019, 60% of value (USD 133.3mln) and 62% of volume (43.4mln litres) came from trade with Russia. The rest of CIS and Ukraine accounted for 19% of generated export revenues. Interconnected economies of these countries and the political risks in the region remain one of the main challenges for Georgian wine sector, as the economic state and exchange rate dynamics of the trade partners affect the demand and prices of Georgian wine there.

The USA, Germany, China, Japan, the UK, Canada, Poland, Switzerland, the Netherlands, Russia, Ukraine and Kazakhstan are the most attractive countries for Georgian wine export. Total imports of these countries from traditional wine producers equals USD 18bn, whereas imports from niche countries totals USD 1bn. These are the two primary segments Georgian wine could compete in.

The upside on domestic markets can be found in bottled refined products and tourism. The turnover of wine and spirits companies on local market are stagnating. At 19.9 litres per year, per capita wine consumption in Georgia is declining, as the consumers switch to standardized bottled products. We believe that in line with increasing visitor numbers and the average length of stay, tourism will increasingly drive the domestic consumption of wine in future.

The wine sector in Georgia is financially healthy. Sector's stable and low leverage underlines room for further growth. Liabilities accounted roughly 40% of wine producers' assets, while NWC ratio increased from 2.1 to 2.3 YoY in 2018. EBITDA/Interest expense and Debt/EBITDA was 6.3 and 2.6 in 2018, respectively, meaning the industry's liquidity risks are low. However, the high concentration of sales on single market poses the risk for sales and profitability.

INDUSTRY OVERVIEW

Georgia counts its history of producing alcoholic beverages not into centuries, but rather into millennia. The UNESCO recognizes Georgia as the Cradle of Wine, acknowledging that the locals were already making wine here 8,000 years ago. In addition, the UNESCO listed traditional Qvevri method of winemaking in its Intangible Heritage of Humanity list in 2013. According to the Georgian Wine Agency, 525 endemic grape varieties are found in the country, of which c.30 are cultivated commercially, and 20 Protected Designation of Origin (PDO) wines are produced as of the end of 2019.

Turnover of Georgia's alcohol industry is on a rise. Total revenues generated by local alcoholic beverage producers increased at a 9-year CAGR of 16.1%, expected to total GEL 1.47bn in 2019 (+15.7% YoY). We expect the formal alcohol market to account for 91% of total turnover in 2019, while informal producers (wine and spirits) to grab 9% of total turnover, approximately the same as in 2018.

FIGURE 1: GEORGIA-BASED ALCOHOLIC BEVERAGES PRODUCERS' TURNOVER¹ (MLN GEL)

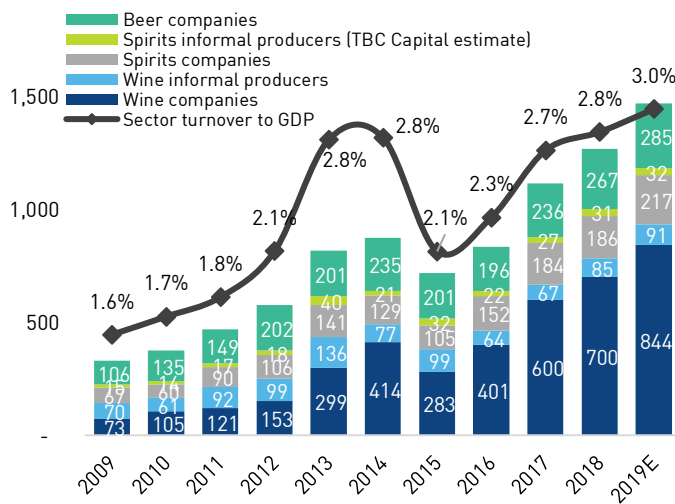
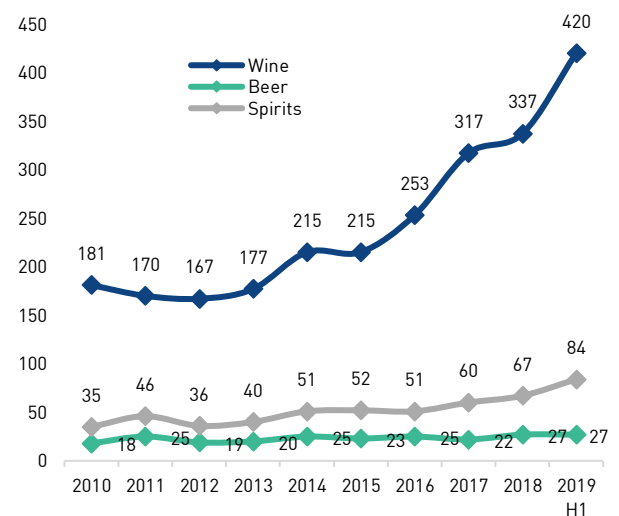


FIGURE 2: NUMBER OF ACTIVE COMPANIES IN ALCOHOLIC BEVERAGES SECTOR



Source: GeoStat, ITC, GWA², TBC Capital

The growing market and sizable profit margins is attracting new producers. Availability of finance via state-subsidized loans and grants in past years increased the sector attractiveness among potential entrants, resulting in a large number of small-size registered companies in the wine sector. The industry features 420 producers of wine (2.3x increase from 2010), 84 of spirits (2.4x), and 27 of beer (1.5x), excluding unregistered producers (mainly households).

TABLE 1: DISTRIBUTION OF COMPANIES BY SIZE³

Size	Wine	Spirits	Beer
Large	5	1	4
Medium	27	5	2
Small	388	78	21

Source: GeoStat

The wine and spirits market is largely fragmented. The large companies generated 29% of the market turnover in 2018, up from 27% in 2017. The reason for such a low concentration level is the current agricultural land ownership structure in the country, as mostly small-scale farmers (95.4% of whom owned less than 1 ha as of 2014 census) own vineyards. In the past years, wine producers focused on purchasing grapes from locals rather

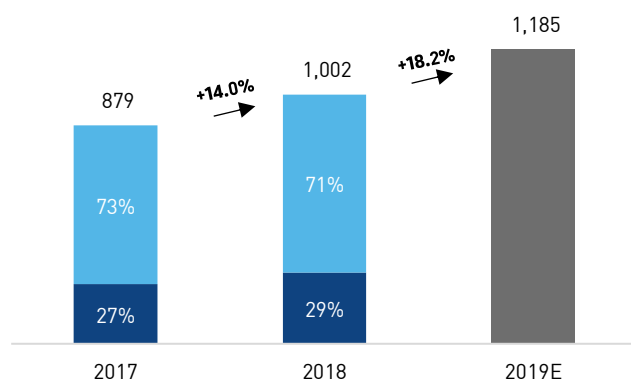
¹ Including household shadow turnover. The turnover of companies registered as either a Wine Producer, or a Spirits Producer (according to the NACE.2 Classification) is counted in respective category. Nevertheless, part of the Wine Producer's turnover comes from selling spirits, and vice versa.

² Georgian Wine Agency numbers tend to slightly diverge from GeoStat data due to methodological differences.

³ As of H1 2019. Large: number of employed > 249 persons and/or volume of avg. annual turnover > GEL 60mln. Medium: number of employed ranges from 50-250 persons and avg. annual turnover – GEL 12mln-GEL 60mln. Small: number of employed < 50 persons and avg. annual turnover < GEL 12mln.

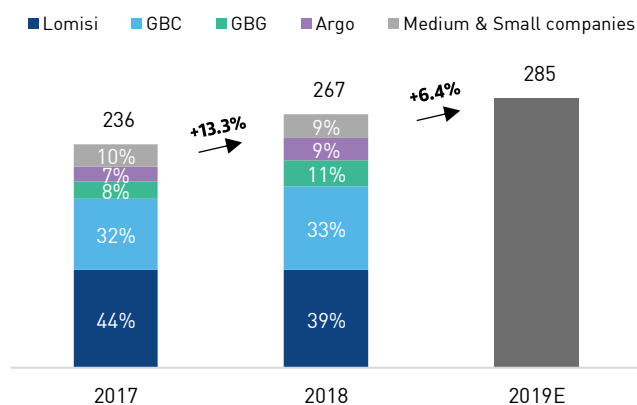
than cultivating. Going forward, we expect the concentration of large companies to increase due to the growing demand for standardized, high quality products as well as for achieving the economies of scale, needed to push the costs down in the long term.

FIGURE 3: GEORGIA-BASED WINE AND SPIRITS PRODUCERS' TURNOVER⁴ (MLN GEL)



Source: GeoStat, SARAS, TBC Capital

FIGURE 4: GEORGIA-BASED BEER PRODUCERS' TURNOVER (MLN GEL)



Unlike wine, beer production is highly concentrated, with large companies capturing 90.6% (+0.6pp YoY) of the total sector turnover in 2018. JSC Lomisi led the sales in 2018, representing 38.5% of the market. Georgian Beer Company JSC (GBC) was a runner up, accounting for 32.8% of the total turnover. On the expense of Lomisi and other (medium and small) companies losing their portions of the market, Global Beer Georgia LLC (GBG) and JSC Argo have increased shares in 2018, increasing to 10.5% and 8.7% respectively, from 7.6% and 6.7% in 2017. After the acquisition of the brand name and commercial assets of Kazbegi JSC by GBG in the first half of 2019, the level of market concentration increased further.

WINE SUPPLY: PRODUCTION HITTING THE ALL TIME HIGH

Georgian wine industry has progressed through many challenges since 2006. With Russian embargo in place, supply declined sharply in 2006 and continued to weaken for the next three years. Before the embargo, Russia was easily the exclusive importer of Georgian wine, with 87% and 77% shares in export volume and value, respectively. Facing the ban, Georgian producers started targeting alternative markets, refining their production and product quality. Supply started to pick up from 2010 and skyrocketed in 2014, when the embargo lifted.

Wine production in Georgia is gaining momentum. The volume of wine production is expected to surge by 26% in 2019, reaching 21.7mln decalitres, with total value of GEL 1bn. The formal production is already up by 40.3% in 9M 2019. This surge is mostly attributable to the fruitful Rtveli of last two years. Production of sparkling wine almost doubled in last two years, but remains modest. 0.31mln decalitres were produced in 2018, with a value of GEL 21mln and the production is expected to increase to 0.53mln decalitres (GEL 30.8mln) in 2019.

Higher production of wine from large-scale producers will further substitute household production. Household wine production has been decreasing from 7.3mln decalitres to 4.1mln decalitres until 2016, after which the production increased to 5.2mln decalitres in 2018. We expect the household production to reach 5.7mln decalitres in 2019, on the back of increased harvest. In longer term, in line with the increasing purchasing power, the local demand will continue shifting towards better quality, standardized drinks and away from homemade wine. The growing urbanization and decline in self-subsistent agriculture will push the formalization, and people who used to be on the supply side of the market will move to the demand side for bottled wine. The accumulation of harvest-bearing vineyards stock by registered winemakers underpins the trend. Alternatively, former informal wine producers might increasingly act as grapes suppliers for the formal producers, or organize into enterprises themselves.

⁴ We have consolidated wine and spirits markets, as the players producing wine also produce brandy (and other spirits) and vice versa.

FIGURE 5: PRODUCTION OF WINE AND SPARKLING WINE GOODS – VOLUME (MLN DECALITRES)*

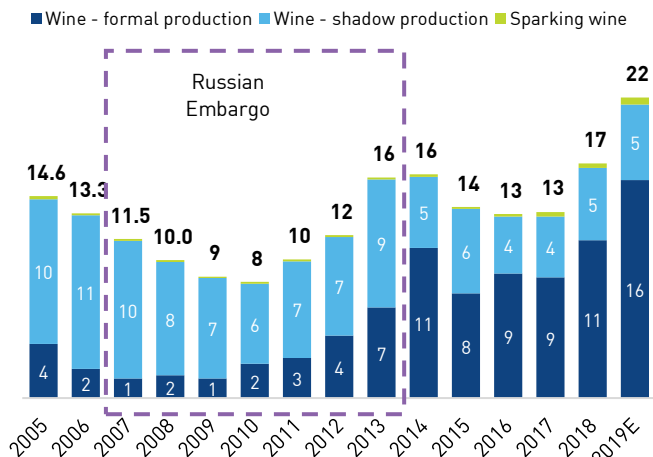
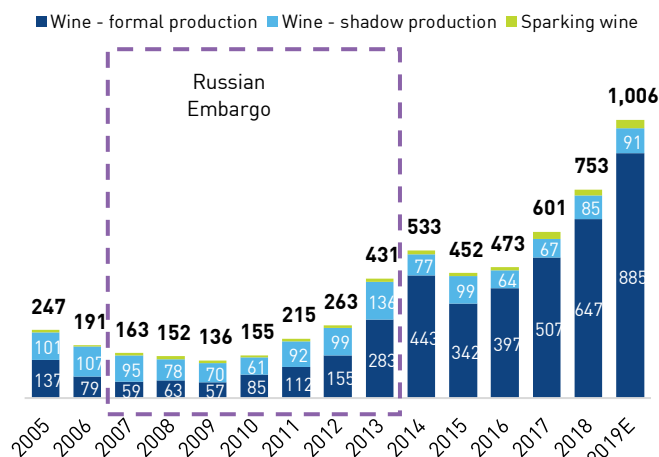


FIGURE 6: PRODUCER’S VALUE OF WINE AND SPARKLING WINE GOODS – VALUE (MLN GEL)

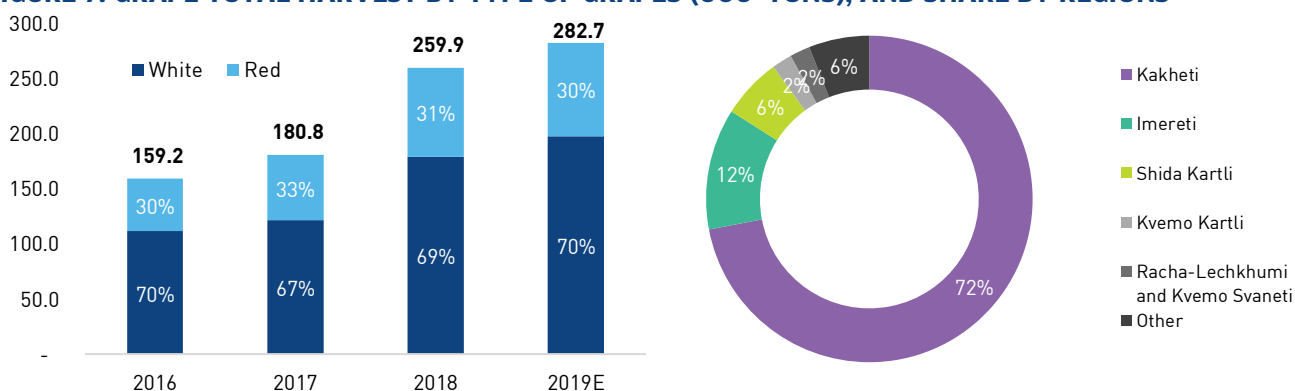


Source: GeoStat, TBC Capital; *Note: Stocked wine from previous harvests can be used for producing finished goods by companies; Winemakers increasing production to match excess demand from Russia caused a relatively higher jump in 2014

White grapes represent a bigger chunk of the production. 29% of the total harvest is estimated to be red grapes in 2019, -1 pp compared to 2016. Switching to production of non-common grape species is of a great necessity, as they can produce high quality niche-type wines. More varieties, with small scale production each, can satisfy diverse small-scale markets with distinct tastes worldwide. Past decade witnessed Kisi and Rose entering the market, but the vineyards substitution is a long and expensive process. We expect the proportion to shift further in favor of red wines, as target exporting markets prefer Georgian dry and semi-sweet red wines and the proportion of red wine producing grape varieties is higher in new vineyards, while Rkatsiteli share is rather limited.

Kakheti represents nearly three quarters of Georgia’s total grape production. 73% of Georgian vineyards are concentrated in this region, accounting for 72% of the total harvest in 2018. Imereti constitutes for 12% of the production. Racha-Lechkhumi and Kvemo Svaneti with the scarce vineyard area and smaller share of the harvest (up to 2%), boasts with special micro-zones and high concentration of PDOs.

FIGURE 7: GRAPE TOTAL HARVEST BY TYPE OF GRAPES (000’ TONS), AND SHARE BY REGIONS*



Source: GeoStat; *Regional distribution as of 2018, 2019 numbers will be available in June 2020.

“Rtveli” broke the 30-year record twice in a row⁵. Within the Government’s “Rtveli” program framework, the amount of processed grapes (estimated 90% of country’s harvest) increased by 10% YoY to 271 thousand tons in 2019. 430 wineries were involved in the process. In 2018, 249 thousand tons (+86% YoY) of grapes with total value of GEL 316mln (+92% YoY) were processed into wine or related products. Despite the fruitful harvest, revenues from grape processing stagnated in 2019 at slightly above the GEL 300mln level, as Rkatsiteli prices declined YoY. The lower demand was mainly due to the excess stock of Rkatsiteli wines from the previous year.

⁵ Rtveli data is based on Georgian Wine Agency statistics, which differ from GeoStat data, mainly due to the difference in coverage of grape harvests

The Government of Georgia is actively supporting the industry. The state-initiated Agro insurance program co-finances 50% of insurance premium for grape harvest vineyards on up to 5ha area. Per EU-Georgia Association Agreement, the Government works on traceability of grapes species, ensuring the higher quality. Since 2008, the government had been subsidizing grape production until 2018, as the industry evolved and gained strength.

Rkatsiteli and Saperavi account for more than 90% of total grape production in Georgia. The share of Rkatsiteli in the total grape harvest has decreased by 4 pp for the seven-year period and it accounted for more than 60% of total estimated harvest in 2019. In contrast, the share of Saperavi decreased marginally to 30% (-1 pp) in the same period. The reason for such dominance of these two varieties were the relative ease of cultivation and good resilience to unfavorable weather conditions. Nowadays, the growing diversification of tastes drives interest for other endemic species too. Processing of Kakhuri Mtsvane, Tsolikauri, Ojaleshi and others had been increasing over the past years. Although according to GWA preliminary data, the combined share of these grapes decreased to 6% of total processed harvest, these numbers tend to get reviewed by June, and we expect this share to be somewhat higher.

FIGURE 8: PROCESSED GRAPE (000' TONS)

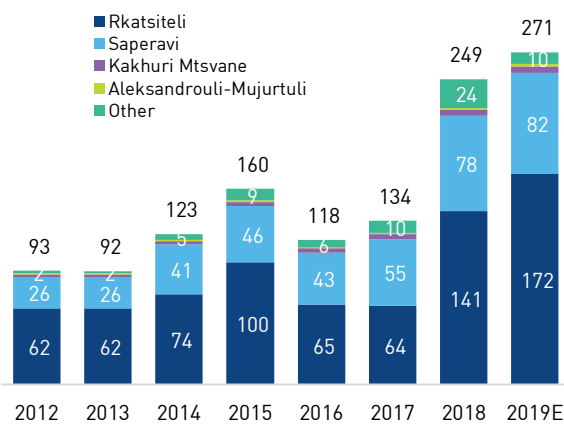
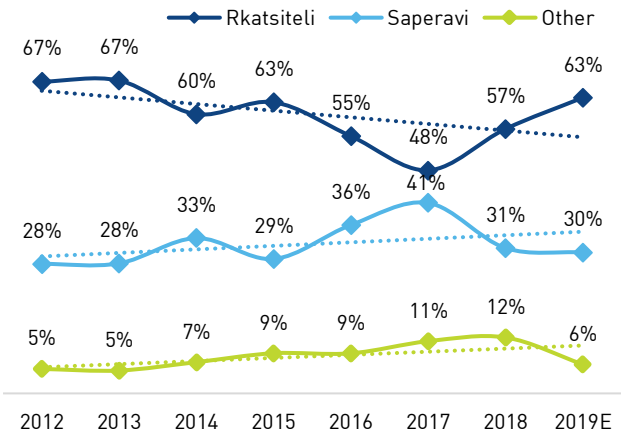


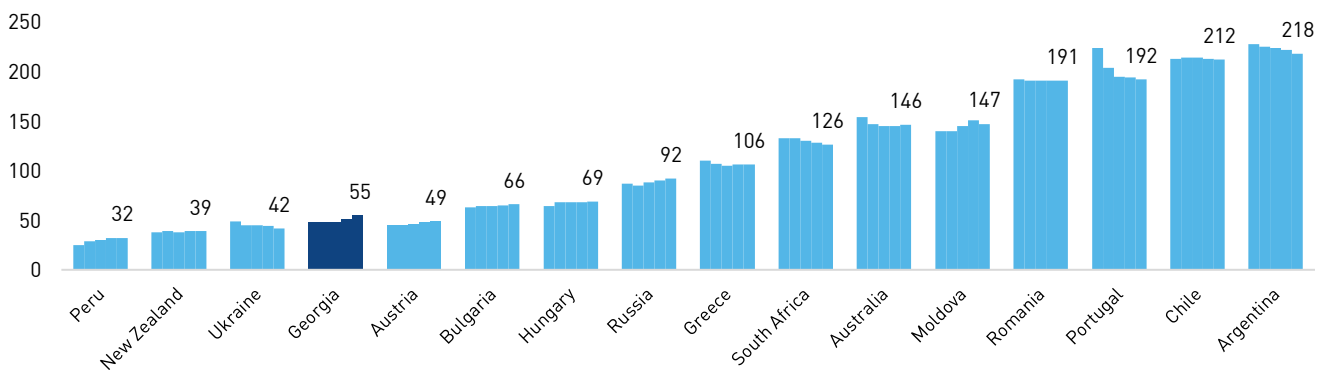
FIGURE 9: SHARE OF PROCESSED GRAPES SPECIES (%)*



Source: GWA; *We expect the share of other grapes to align more with the trend after the final review of the harvest figures.

Limited feasible capacity of production will remain a natural barrier for Georgian wine to become a mass product in the short term. Country's limited supply of vineyards, currently at 55 thousand⁶ ha in total (<0.5% of the world vineyard stock), paired with low productivity in the sector, results in limited production capacity. Although small in absolute terms, note that vineyard area in the country has been increasing with CAGR 3.4% since 2014.

FIGURE 10: VINEYARD AREA 2014-2018 (000' HA)*



Source: OIV, FAO; *According to GeoStat, the total area of vineyards in Georgia is 36.1 thousand HA as of 2017;

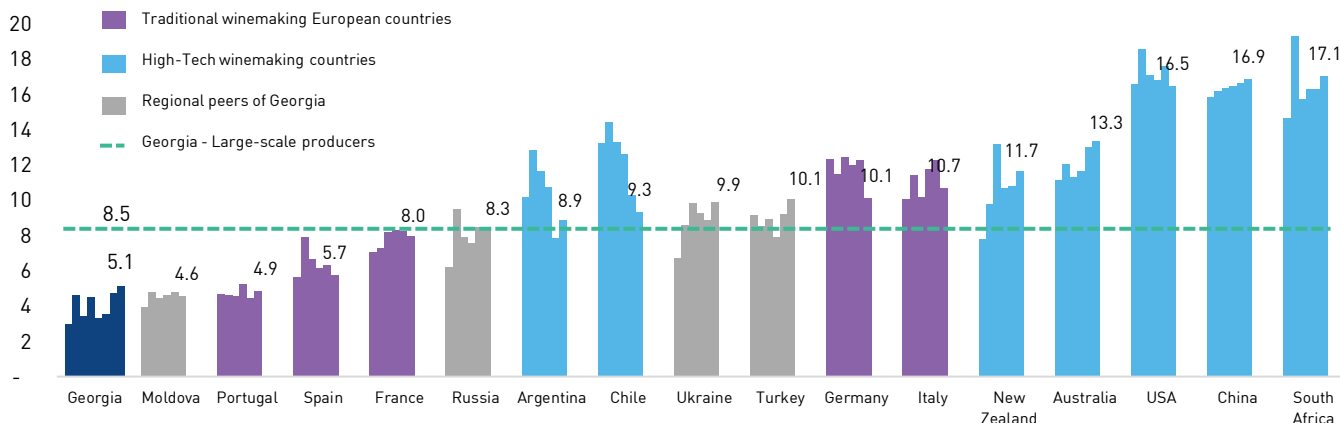
With an average yield per hectare, Georgia lags behind most of other, major wine exporters globally. Although rising, the current grape yield in Georgia stands low at 5.1 ton/ha, falling behind to regional wine producer peers. According to the World Food and Agriculture Organization data, per hectare productivity has been on the rise in

⁶ OIV statistical report

Russia (8.3), Ukraine (9.9) and Turkey (10.1) in a six-year period. Further, the yield in high-tech producers like Argentina and South Africa surpasses Georgia's per hectare productivity by factors of 1.7x and 3.4x, respectively.

In contrast, productivity of large-scale producers who own new and productive vineyards stands at 8.5⁷ tons per ha in Georgia, 2.1x higher compared to the average of the rest of the country. Domestic producers can improve the productivity through consolidation as the current low level is defined with high saturation of small-scale farmers, who are unable to achieve the economies of scale and, respectively, have costlier production. Old vines, lack of modern cultivation techniques and technology are additional issues.

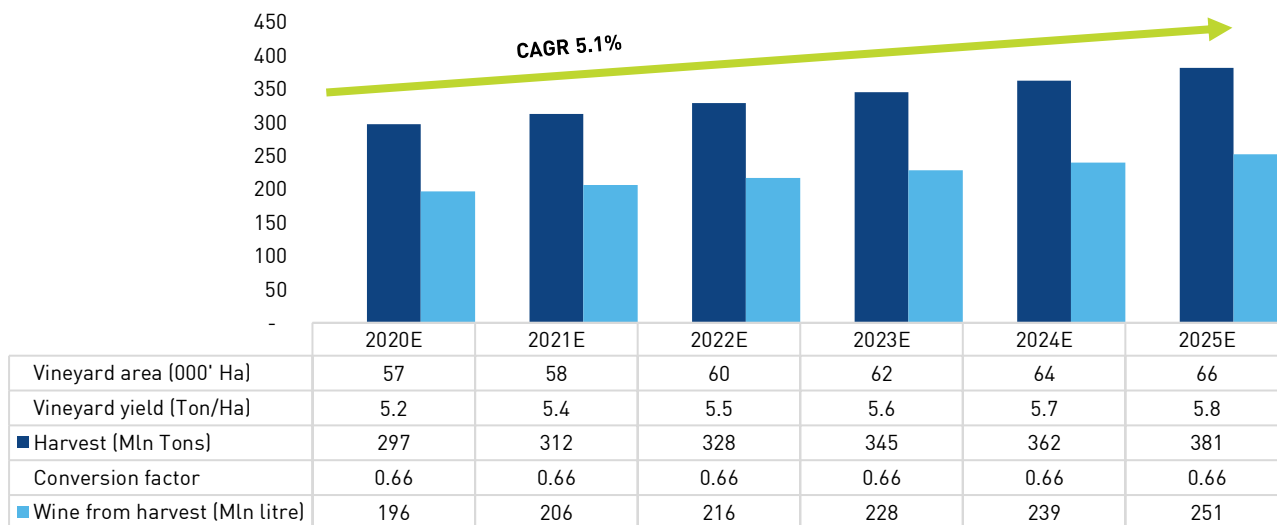
FIGURE 11: VINEYARD PRODUCTIVITY – GEORGIA: 2012-2019* (TON/HA)⁸



Source: FAO, GeoStat, TBC Capital; *other countries 2012-2017; Note: Vineyard area for Georgia is based on OIV data; According to FAO, productivity is 3.654 ton/ha

There is a delicate balance between overproduction and the quality of wine. Higher grapes yields are achievable through consolidation of sparse vineyard plots into bigger units, investing in technology, and renewing vineyard stock. Compiled by the National Wine Agency of Georgia, the vineyard cadaster will back the streamlining of the consolidation process. On the flip side, keeping the yields below certain threshold is a precondition for high quality – a rational behind the National Wine Agency of Georgia recognizing only up to first 10 tons of Saperavi grapes per hectare suitable for producing PDO wines such as Kindzmarauli, Mukuzani, Kvareli and Akhasheni.

FIGURE 12: PROJECTED GRAPE PROCESSING AND WINE PRODUCTION (TON) IN 2019-2025



Source: TBC Capital

⁷ Based on a sample of large producers

⁸ High-tech winemaking countries entered the winemaking market recently and rely heavily on technology and industrial production techniques. The productivity and cultivated area increases in those countries; Decreased productivity in Argentina and Chile was due to unfavorable weather conditions in 2016-2017.

We expect the wine production to increase by CAGR of 5.1% until 2025, on the back of new vineyards and increased productivity. Up to 20% of the total vineyards area is new, the production efficiency of which will reach its maximum level by 2025. By that date, we project the amount of the annually processed grape at 381 thousand tons (six-year CAGR 5.1%).

IRR for production of different grapes ranges between 14.0% and 18.0% and a project payback period varies from eight to ten years. Our estimated initial investment per ha for different grape varieties for factory level production ranges between USD 21,000-40,000, with vineyards of PDO wines, or in special microzones being the costliest. With new vineyards, producers could expect up to 10 tons of grapes on one ha. Yield reaches its full capacity within the first six years and the harvest volume largely depends on geographical area of the land, and quality of production factors (e.g., pesticides). Rkatsiteli is the most widespread and fruitful grape variety, while the maximum capacity for some rare types of grapes and PDOs are generally lower. Current state program of subsidizing the interest on agricultural loans helps increase the equity IRR significantly.

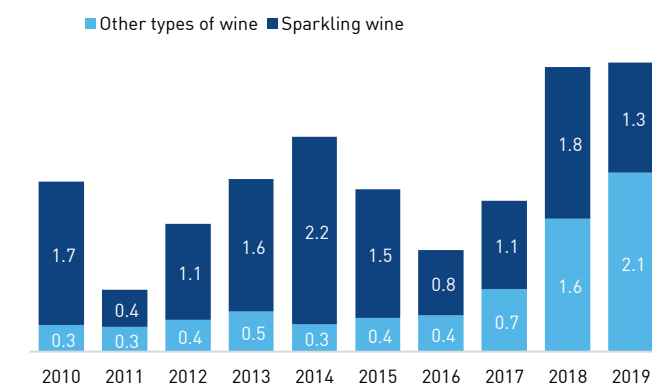
TABLE 2: IRR AND PROJECT PAYBACK PERIODS FOR DIFFERENT GRAPE SPECIES⁹

Grape Type	100% Equity financed		
	Initial Investment (USD)	IRR	Payback (Y)
Ojaleshi-Chkhaveri	33-35K	17.5-18.0%	7-8
Saperavi (Kindzmarauli, Mukuzani)	33-35K	16.0-16.5%	7-8
Aleksandrouli-Mujuretuli	38-40K	16.0-16.5%	7-8
Khikhvi, Kisi	21-23K	16.0-16.5%	7-8
Krakhuna	21-23K	16.0-16.5%	7-8
Shavkapito	22-24K	15.0-15.5%	7-8
Chinuri, Goruli Mtsvane	22-24K	15.0-15.5%	8-9
Tsolikauri	21-23K	15.0-15.5%	7-8
Tavkeri, Tetri Budeshuri	22-24K	14.5-15.0%	7-8
Otskhanuri Sapere	22-24K	14.5-15.0%	8-9
Rkatsiteli	21-23K	14.5-15.0%	8-9
Saperavi	22-24K	14.0-14.5%	8-9

Source: TBC Capital Research

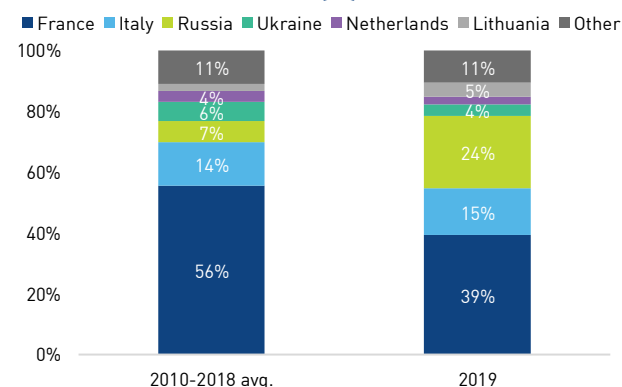
Georgia imports insignificant amount of wine, and the share of sparkling wine in these imports is dropping. In 2019, total value of imported wine amounted to USD 3.46mln and the share of sparkling wine was down to 38% versus 84% in 2010. Respectively, the structure of imports by suppliers also changes. Accounting for 79% of total imports in 2010 (56% on average in 2010-2018), France accounted only for 39% of import value in 2019 in Georgia.

FIGURE 13: IMPORTS OF SPARKLING WINE AND OTHER TYPES OF WINE IN GEORGIA 2010-2019 (MLN USD)



Source: ITC

FIGURE 14: IMPORT STRUCTURE BY COUNTRIES 2010-2018 AVG vs 2019 (%)



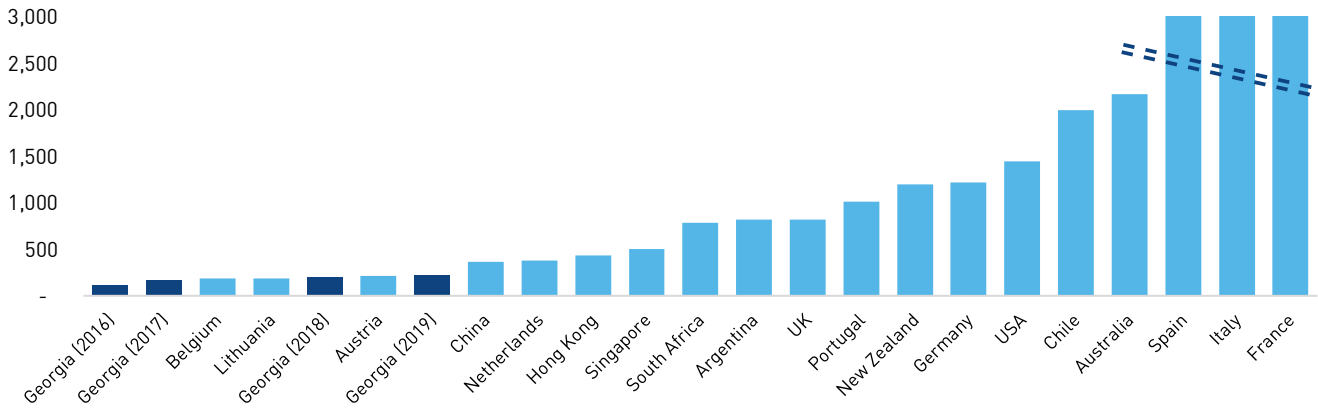
Source: UN Comtrade;

⁹ Projected IRR and Payback Period for different grape types is based on the modelling of TBC Capital research team

WINE DEMAND: ENTERING THE NEW EXPORT MARKETS

Georgia is among the Top 20 wine exporting countries globally. With the export value of USD 197mIn, Georgia ranked 18th in 2018, improving its position by one place from the previous year. As of 2019, the export value grew to USD 223mIn.

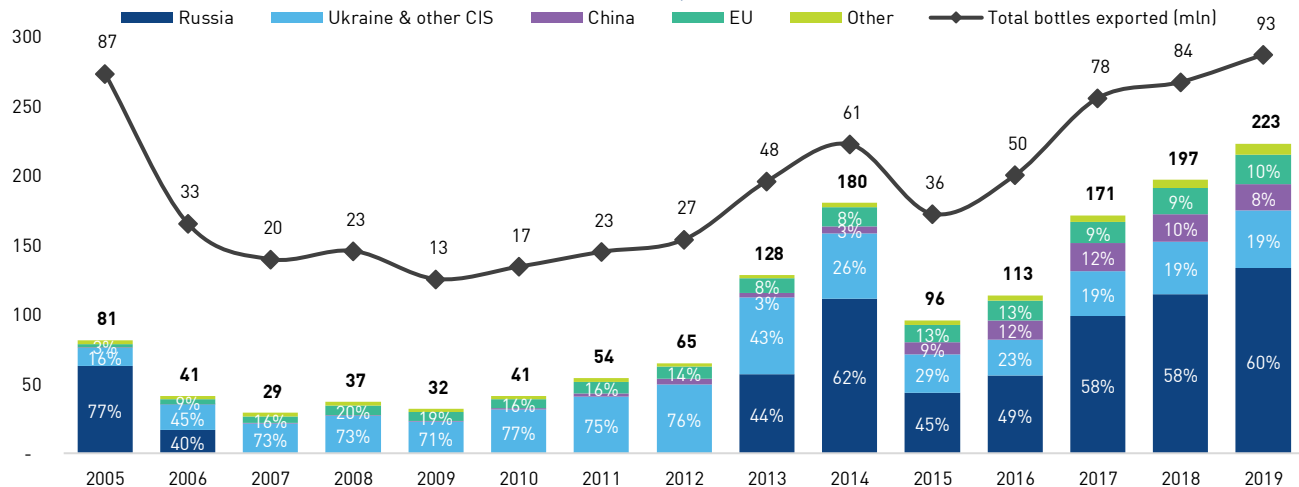
FIGURE 15: TOP COUNTRIES EXPORTING WINE – EXPORT VALUE (MLN USD)



Source: ITC; Note: Countries except Georgia are as of FY 2018. France, Italy and Spain are off axis limits, with export values totaling USD 11.0bln, USD 7.3bln and USD 3.5bln respectively

Georgia's wine export of 2019 improved the record of 2018, growing 13.2% YoY. Reaching USD 223mIn in the last year, the value of exported wine has been increasing with CAGR +23.5% in the last four years. The proportion of exports to total turnover of wine companies is expected to reach 83% in 2019, up from circa 79% in 2018. The sizable share of exports in total turnover comes with no surprise, as Georgia's wine production largely exceeds the local consumption and wine, the fourth largest export good of the country, generated 5.9% of Georgia's total export revenue in 2019. For 2019, estimated volume of export exceeds 93mln bottles.

FIGURE 16: WINE EXPORT FROM GEORGIA IN 2005-2019, VALUE (MLN USD) AND VOLUME (MLN BOTTLES)



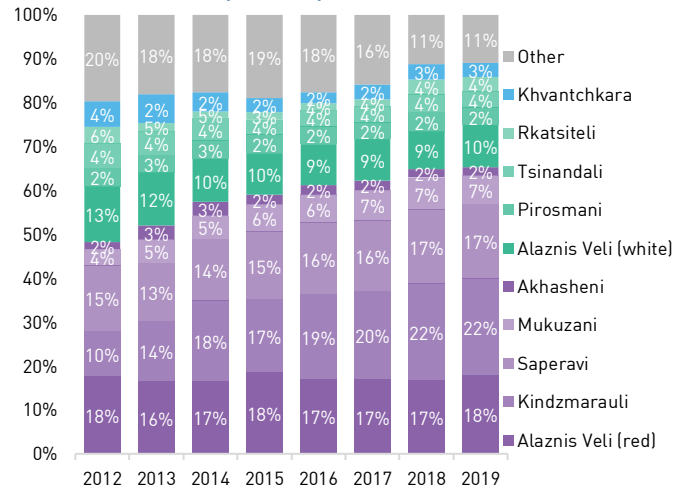
Source: ITC, TBC Capital; Note: Russian embargo hit the market in mid-2006; Economic problems in Russia and Ukraine resulted in decrease of exports in 2015;

Russia is the leading buyer of Georgian wine by a sizable margin. Georgia generated 59.8% (USD 133.3mIn) of total wine export revenues in 2019 from Russia, with the proportion in volume standing even higher at 61.5% (43.1mln litres). For the last decade, the exports of Georgian wine in China grew from negligible USD 0.6mln in 2009 to sizable USD 18.9mIn in 2019 and the country became third biggest importer of Georgian wine worldwide. Exports in Kazakhstan were down to USD 8.5mIn in 2019 from USD 16.5 five years ago, now close to 2011 level. The sales picked up in Ukraine at a +31% CAGR between 2015 and 2019 and reached USD 23mIn, still lower compared to the USD 30mIn in 2013.

Mid-to-high class wines¹⁰ represent c. 44% of Georgia's total wine exports. Khvanchkara is the most expensive, with average export price standing at USD 7.63 in 2019, while the prices of other top exported wines ranges between USD 2-3. Alaznis Veli are the top exported Georgian wines, generating 28% of the total wine export revenues and this share has been stable for the past five years. Share of top 4 wines from Rkatsiteli grapes make up to 21% of exports, while share of top 5 wines made solely or partially from Saperavi constitute 63% of export.

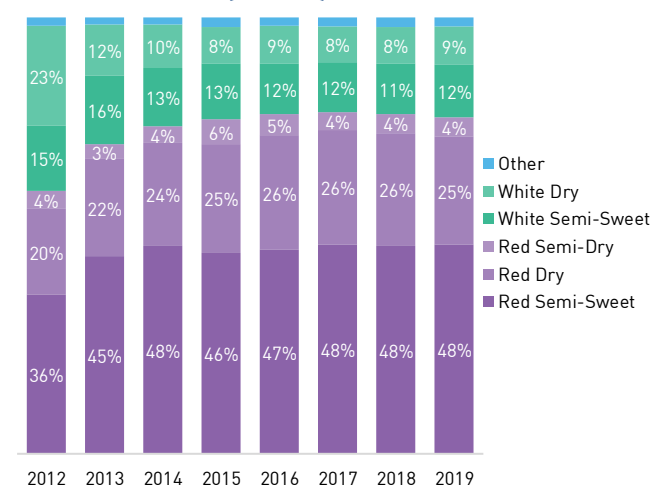
Red semi-sweet is the most popular exported wine type, with red dry as a runner up. Together they accounted for 73% of total wine exports in 2019. The high proportion of these wines in export is a result of consumer taste in the CIS that holds the lion's share in Georgia's wine export.

FIGURE 17: GEORGIAN WINE EXPORTS BY TYPE OF WINE 2012-2019 (VALUE)



Source: GWA, TBC Capital

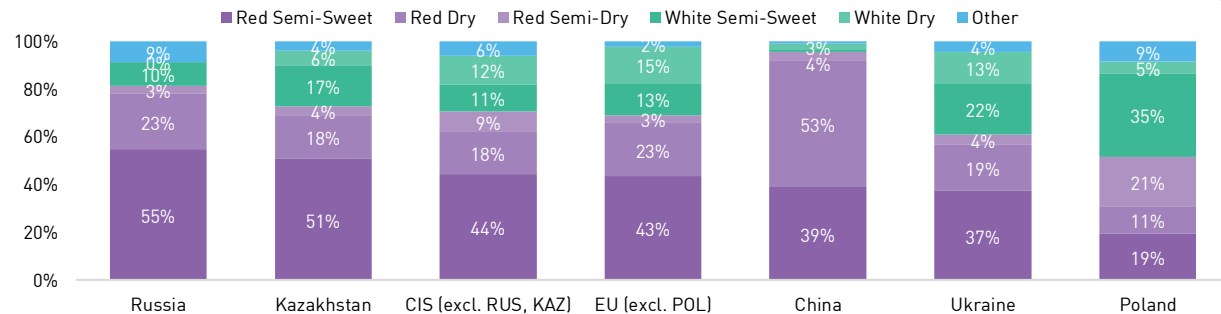
FIGURE 18: GEORGIAN WINE EXPORTS BY TYPE OF WINE 2012-2019 (VALUE)



Source: GWA, TBC Capital

Wine export structure differs markedly by destinations. White semi-sweet wines represented 35% of wine export value in Poland in 2019, while red dry wines captured 53% of value in China. As for Russia and Kazakhstan, over half of the exports (55% and 51%, respectively) were red semi-sweet wines. The breakdown was similar for the rest of the CIS and the overall pattern was broadly unchanged from 2018.

FIGURE 19: GEORGIAN WINE EXPORTS IN TOP EXPORT MARKETS BY TYPE OF WINE IN 2018-2019 (VALUE)



Source: GWA, TBC Capital

Tastes on target export markets are heterogeneous: European consumer prefers classic wines, light and dry. Color is not of a high importance, although of Georgian product, red dry wine matches their taste better. Consumers from Russia and other CIS countries prefer sweet and semi-sweet red wines, with higher concentration of alcohol. As for the Chinese market, high-income individuals tend to consume more dry and semi-dry wines, while people with lower income mostly purchase sweet and semi-sweet wines.

¹⁰ Saperavi, Kindzmarauli, Mukuzani, Khvanchkara and Tsinandali and other.

Analyzing the sample of countries with annual wine consumption of over 1mln hectoliters, produces results in line with Georgia’s wine strategy. We base our analysis upon the criteria of attractiveness and riskiness. Based on these criteria we assessed potentials of different foreign wine markets to identify the potentially lucrative markets for Georgian wine, sorting them by the ranking produced.

TABLE 3: EXPORT MARKET ATTRACTIVENESS AND RISKINESS ANALYSIS

Weight	Market Attractiveness								Total rank	Market Riskiness					
	30%		30%		20%		100%			40%		30%		100%	
Country parameters	Total wine import (USD)	Rank (1-5)	Import from Georgian wine producers (USD)	Rank (1-5)	Distance to Capital (Km)	Rank (1-5)	Avg. price of imported wine USD/Ton	Rank (1-5)	S&P Credit Rating	Rank (1-5)	Economic Freedom of the World Index	Rank (1-5)	Transparency International CPI	Rank (1-5)	Total Rank
USA	6,449,227	5.00	2,139	3.60	9,291	2.62	5.60	4.00	AA+	5	77	4.32	69	3.83	1.60
China	2,855,245	2.77	18,996	3.90	5,842	3.72	4.18	3.28	A+	5	58	1.90	41	2.00	2.99
Russia	1,051,134	1.65	166,147	5.00	1,982	4.95	1.79	1.71	BBB-	3	59	1.93	28	1.00	3.92
Germany	3,144,628	2.95	1,644	3.50	3,194	4.57	2.14	1.94	AAA	5	74	3.88	80	4.59	1.46
Japan	1,687,726	2.04	1,206	3.26	7,820	3.09	6.35	4.71	A+	5	72	3.69	73	4.10	1.82
UK	4,357,680	3.70	356	1.67	4,228	4.24	3.10	2.57	AA	5	79	4.60	77	4.38	1.39
Ukraine	125,253	1.07	20,664	4.00	1,836	5.00	2.61	2.25	B	2	52	1.05	30	1.14	4.46
Poland	354,096	1.21	7,549	3.70	2,620	4.75	2.69	2.31	A-	4	68	3.12	58	3.07	2.42
Canada	1,995,589	2.23	872	2.63	8,668	2.82	4.73	3.65	AAA	5	78	4.44	77	4.38	1.35
Switzerland	1,214,700	1.75	41	1.08	3,954	4.32	6.79	5.00	AAA	5	82	5.00	85	4.93	1.02
Kazakhstan	41,698	1.02	9,189	3.80	3,261	4.55	1.74	1.68	BBB-	3	65	2.80	34	1.41	3.54
Sweden	783,496	1.48	56	1.10	3,556	4.45	5.82	4.36	AAA	5	75	4.11	85	4.93	1.29
Netherlands	1,367,171	1.84	372	1.70	3,814	4.37	3.34	2.73	AAA	5	77	4.32	82	4.72	1.29
Belgium	1,153,583	1.71	114	1.21	3,891	4.34	3.51	2.85	AA	5	67	3.05	75	4.24	1.89
Norway	439,834	1.27	21	1.04	4,054	4.29	4.94	3.78	AAA	5	73	3.81	84	4.86	1.40
France	1,136,854	1.70	518	1.97	4,373	4.19	1.58	1.58	AA	5	64	2.59	69	3.83	2.16
Austria	255,998	1.15	94	1.18	3,205	4.56	3.62	2.92	AA+	5	72	3.68	77	4.38	1.62
Finland	263,572	1.16	89	1.17	3,085	4.60	3.37	2.75	AA+	5	75	4.07	86	5.00	1.32
Czech republic	263,412	1.16	215	1.40	3,487	4.47	2.97	2.49	AA-	5	74	3.91	56	2.93	2.11
Bulgaria	23,360	1.01	96	1.18	2,195	4.89	2.74	2.34	BBB+	4	69	3.28	43	2.03	2.73
Greece	49,871	1.02	41	1.08	2,749	4.71	2.85	2.41	BB-	3	58	1.77	48	2.38	3.71
Italy	407,469	1.25	126	1.24	3,870	4.35	1.97	1.83	BBB	4	62	2.37	53	2.72	2.83
Romania	74,347	1.04	-	1.00	2,295	4.85	2.14	1.94	BBB-	3	69	3.23	44	2.10	3.20
Croatia	35,967	1.02	-	1.00	1,984	4.95	1.49	1.52	BBB-	3	61	2.27	47	2.31	3.43
Spain	256,289	1.15	25	1.05	5,178	3.93	2.55	2.21	A	4	66	2.84	62	3.34	2.38
Serbia	31,572	1.01	-	1.00	2,595	4.76	1.43	1.48	BB+	3	64	2.60	39	1.76	3.53
Hungary	20,041	1.01	-	1.00	2,970	4.64	0.71	1.00	BBB	4	65	2.75	44	2.10	2.90
Portugal	195,534	1.11	-	1.00	5,732	3.76	0.93	1.14	BBB	4	65	2.79	62	3.34	2.52
Brazil	375,640	1.23	20	1.04	11,387	1.95	3.09	2.57	BB-	3	52	1.00	35	1.48	4.22
Mexico	271,813	1.16	2	1.00	12,263	1.68	3.53	2.86	BBB+	4	65	2.71	29	1.07	3.19
Argentina	10,794	1.00	-	1.00	13,470	1.29	3.90	3.10	B	2	52	1.04	45	2.17	4.16
Australia	622,263	1.38	132	1.25	13,595	1.25	2.52	2.19	AAA	5	81	4.87	77	4.38	1.23
South Africa	49,983	1.02	-	1.00	12,231	1.69	2.68	2.30	BB+	3	58	1.85	44	2.10	3.65
Chile	11,147	1.00	-	1.00	14,381	1.00	3.63	2.93	A+	5	75	4.13	67	3.69	1.81

Source: TBC Capital, OIV, FAO, S&P, Economic freedom of world index, corruption perception index

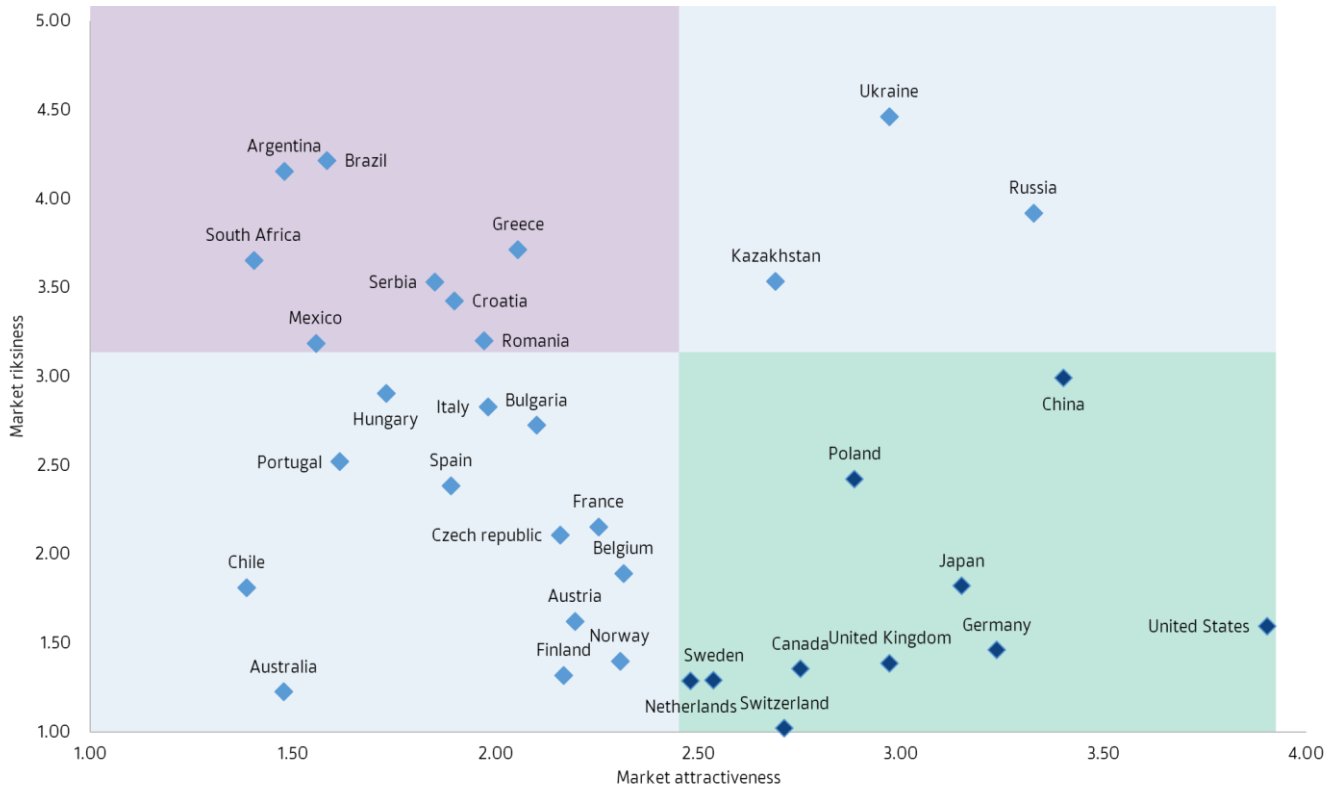
The attractiveness criterion is based upon the following four pillars:

1. **The total wine import (USD):** This pillar measures the total dollar value of the import to indicate the size of the excess demand for wine in the listed countries;
2. **Import of Georgian wine (USD):** Existing higher sales in the country indicates familiarity with Georgian wine. Lower entry barriers are associated with the well-established trade markets;
3. **Average price of imported wine (USD/ton):** This criterion measures how much the country pays for the imported wine per ton on average. These costs incorporate the transportation expenses;
4. **Distance to the country’s capital (Km):** This criterion is a proxy for the cost effectiveness of export based on the geographical proximity;

The risklessness criterion is based upon following three pillars:

1. **Credit ratings:** We used S&P credit rating as a proxy for country's economic soundness;
2. **Transparency International CPI index:** This criterion assesses the misuse of public power for private benefit;
3. **Economic freedom index ranking:** We used the Fraser Institute Index For Economic Freedom of the world as a proxy for market freedom in the selected country;

FIGURE 20: CRITERIA ASSESSMENT FOR WINE EXPORT MARKETS (CURRENT AND POTENTIAL)



Source: ITC, OIV, WB

Based on the overall ranking, the USA, Germany, China, Japan, the UK, Poland, Canada, Sweden, the Netherlands and Switzerland are attractive countries. Russia, Ukraine and Kazakhstan fall into attractive, yet risky category. This list of attractive countries contains countries recognized by the GWA as strategically important markets (like Poland, UK, USA and Japan). According to the Georgian Wine Agency, 1 million bottles of wine are planned to be exported to the USA in 2020.

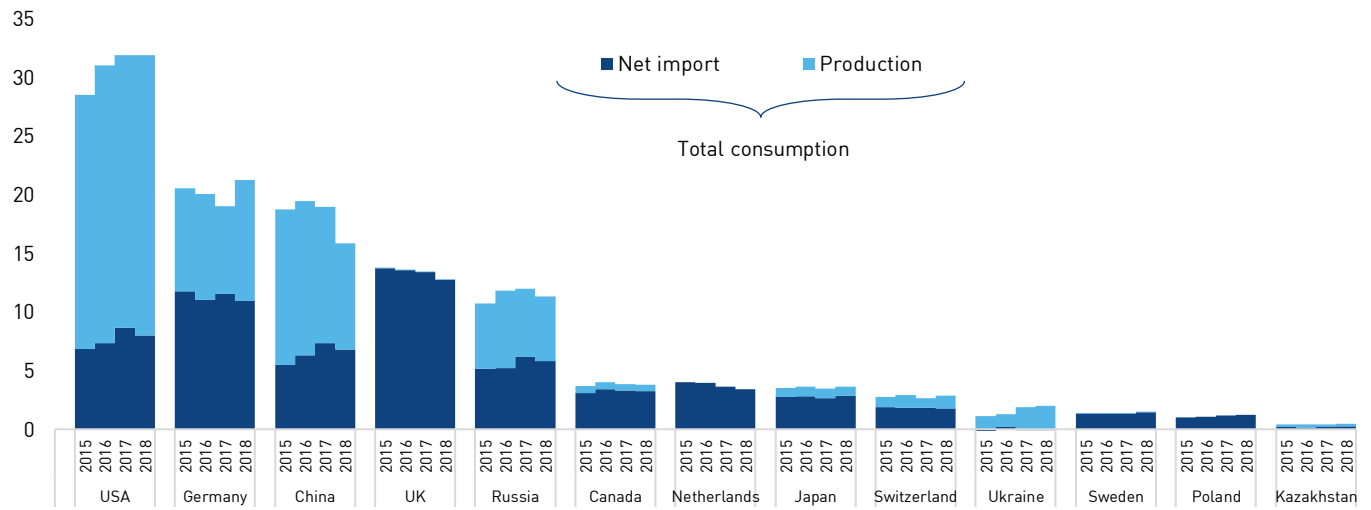
Lack of familiarity can be addressed via active marketing campaigns. Georgia has free trade agreements with many of the analyzed countries and Georgian wine satisfies many of the international quality requirements. The bigger challenge might be achieving a high level of familiarity with Georgian wine among potential customers.

Demand for foreign wine is increasing in China, Poland and Russia. Net wine imports in China grew at a 12.9% CAGR from 2015, totaling 6,775 hl by 2018. The wine industry of China is still emerging and consumer taste is not fully formed, which encompasses a great potential considering 1.4bn population of the country. As for Poland, net imports of wine grew at a 5.5% CAGR since 2015, amounting to 1,239 hl in 2018. We expect the market to exceed 1,300 hl in 2019. The net import in Russia is larger (5,818hl in 2018), but the CAGR is smaller, equaling 3.7% over the same period.

The United Kingdom and the Northern Europe are active buyers on international markets, but due to natural conditions lack own production. The UK was the fifth largest consumer of wine worldwide in 2018, but 99.7% of domestic consumption was satisfied by foreign wines with total value of USD 3.5bn (+4.1% YoY). Sweden, Norway and Finland rely heavily on wine imports, with shares of net imports in total wine consumption standing at 99.7%, 99.5%, and 99.3% in 2018, respectively. Collectively, these three countries spent USD 1.4bn (7.3% YoY) on foreign wines in the same year. We consider Sweden the most interesting country for Georgian wine among the three.

Germany is the world's fourth largest wine consumer, with half of its consumption being net imports. In 2018, the country spent USD 1.9bn (+8.4% YoY) on foreign wines. Despite the volume of net imports fell in the last year, the dollar value has increased as the country concentrates more on high quality, healthier, more expensive wines.

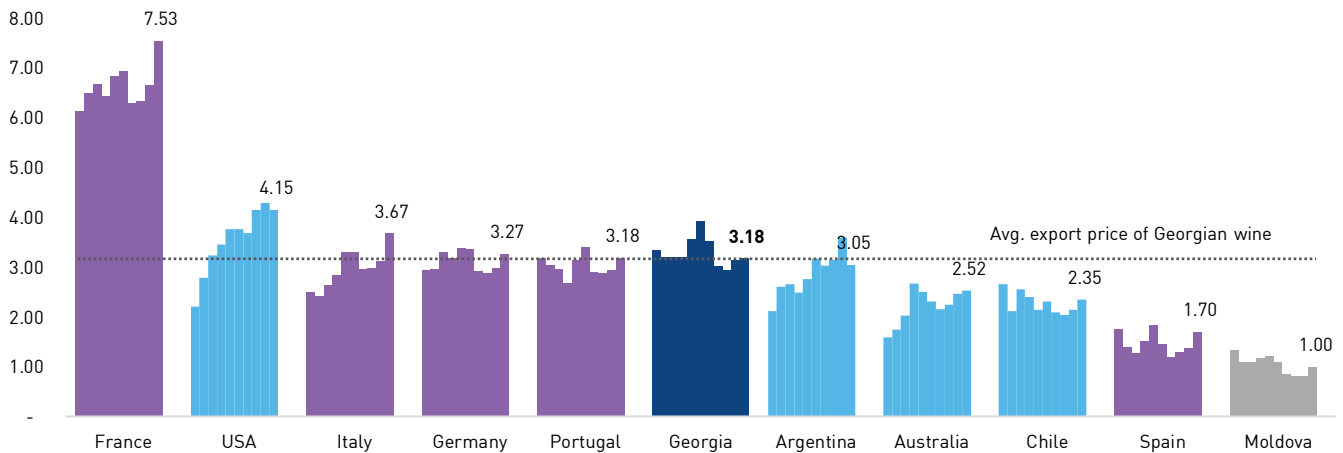
FIGURE 21: GAP BETWEEN CONSUMPTION AND PRODUCTION OF WINE BY COUNTRIES (HL '000)



Source: ITC, OIV, TBC Capital

Georgian exported wine is in medium segment by average export price in the world market. Wines from Chile and Australia are cheaper, compared to Georgia. Mass production and new technologies used in those countries give them the competitive advantage of the lower price. We believe that Georgian producers should concentrate on quality and benefit from the niche market to sustain the market share.

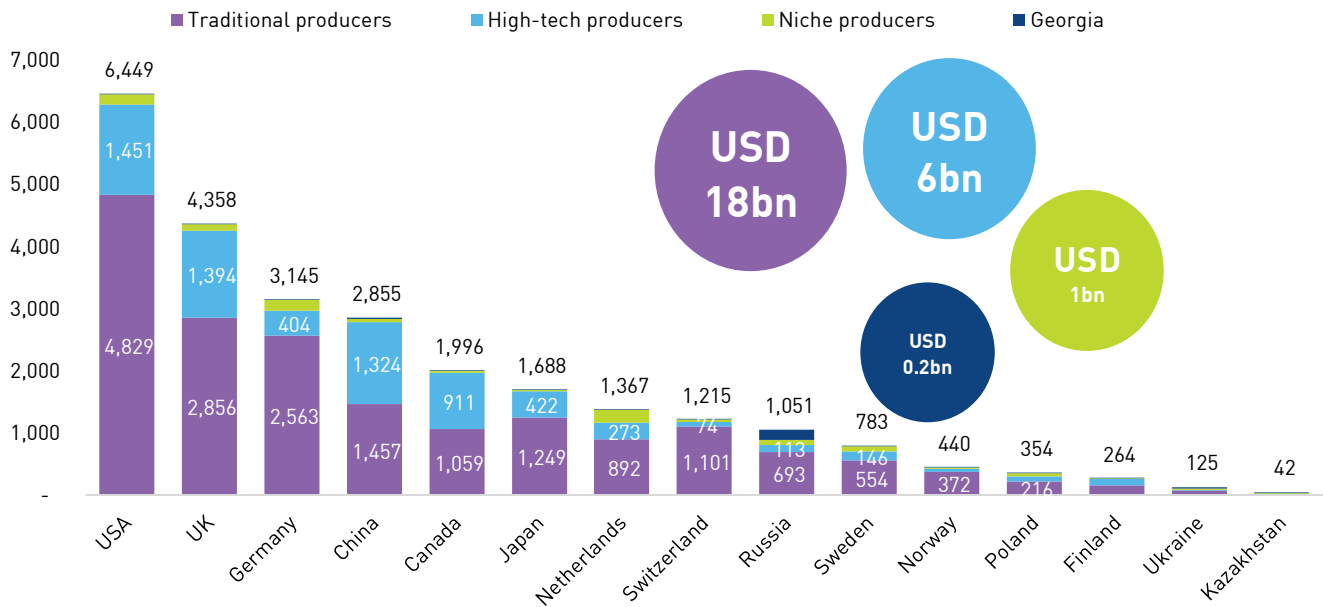
FIGURE 22: AVERAGE EXPORT PRICE OF WINE IN SELECTED COUNTRIES 2013-2019* (USD/LITRE)



Source: ITC, TBC Capital; Note: Georgia 2013-2019, other countries 2013-2018

Georgia has a potential to boost wine exports in target markets. Excluding the imports from traditional and high-tech winemaker countries, in 2018, the country satisfied only 18% of the rest of demand in its target markets. We consider countries from the abovementioned segment as primary competitors, as Georgian producers can compete with them in terms of quality and have enough production capacity to compete in price. We consider the traditional winemakers as secondary competitors, against which Georgia could utilize the 8,000 year-old history of winemaking and the concept of Qvevri wine for positioning. Premium Georgian wines may be a better fit to compete with that segment. Georgian wine will also stay competitive versus some wines of new world high-tech winemakers in terms of quality.

FIGURE 23: WINE IMPORT STRUCTURE BY COUNTRIES (2018)



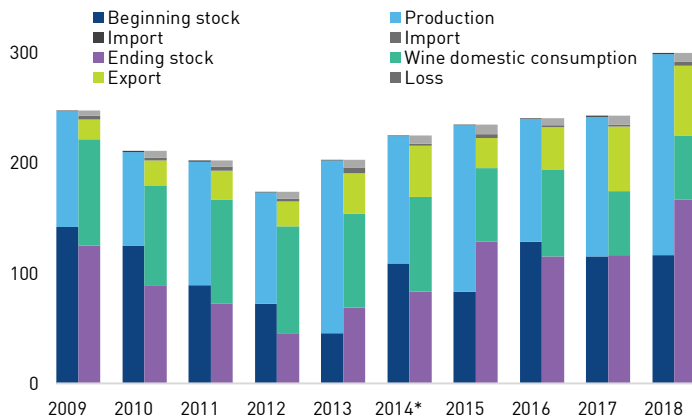
Source: ITC, TBC Capital

Total imports of the selected countries from traditional wine makers equals USD 18bn, whereas imports from niche countries totals USD 1bn. Hungary (6%), Moldova (6%), Greece (5%), Israel (4%), Bulgaria (3%), Ukraine (2%), Romania (2%), Macedonia (2%) and Serbia (1%) are among the producers of the niche exporters to the listed markets.

WINE DEMAND: TOURISM TO DRIVE THE LOCAL MARKET

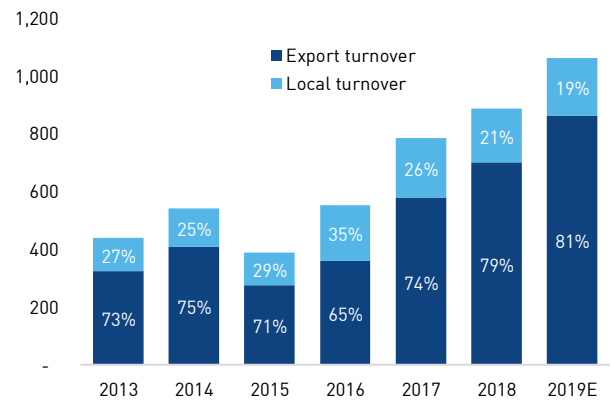
Domestic consumption has gradually lost its place as a largest use of produced wine. From 39% of total wine balance in 2009, its share decreased by 20 pp over the decade down to 19% in 2018, as the exported wine was gaining share. The average stock of wine in the country has increased significantly in 2018, by 7.2mln decalitres, or by 43%, expected to increase further in 2019, due to the fruitful Rtveli, which depressed the grapes prices.

FIGURE 24: WINE BALANCE (MLN LITERS)¹¹ OF FORMAL AND INFORMAL PRODUCTION



Source: GeoStat, TBC Capital, *beginning stock reevaluated in 2015

FIGURE 25: WINE AND SPIRIT COMPANIES TURNOVER: EXPORT VS LOCAL (GEL MLN)



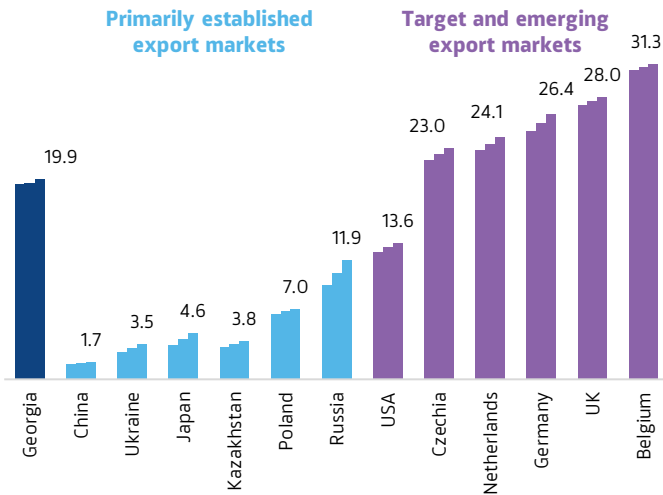
Source: GeoStat, TBC Capital

¹¹ Based on the grapes balance by GeoStat

Volumes of consumed beer and wine in the country had been close, but consumption of wine has been dwindling faster for the past years. The wine consumption is expected to keep approximately the same level at 5.9mln decalitres in 2019, marginally up after the drop of 2016-2017, on the back of growing demand from the tourists. As for beer, the main reason of decreased consumption was the increased excise tax, transferred to the pricing. With growing purchasing power, we expect this effect to fade and the beer consumption trend to reverse.

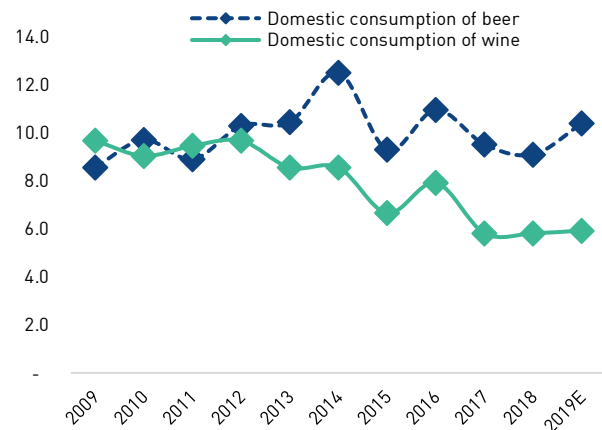
Per capita wine consumption in Georgia has been decreasing. Currently ahead of the CIS and the Eastern Europe, it is more comparable to Western European countries. The annual per capita consumption of wine has been steadily decreasing from 29 litres in 2010 and is expected to just below 20 litres in 2019. According to the World Health Organization, average Georgian adult (+15) consumed 24.6 litres of wine in 2016. Of primary established export markets, per capita wine consumption rebound in Ukraine and Russia, while China displays a steady growth trend. The measure is increasing in the UK, Japan and Czechia as well, while the consumption remained relatively unchanged, but on a higher level in the USA and Germany.

FIGURE 26: WINE CONSUMPTION PER CAPITA 2017-2019 (LITRES PER YEAR)



Source: GeoStat, WHO, TBC Capital forecasts;
Note: Average alcohol concentration equals 13% per litres of wine

FIGURE 27: WINE AND BEER DOMESTIC CONSUMPTION (MLN DECALITRE)



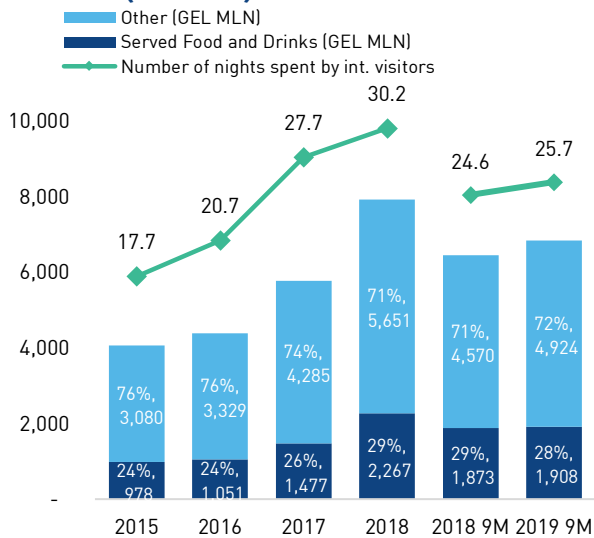
Source: GeoStat, TBC Capital

Popularity of lower alcohol beverages increases. According to WHO, strong spirits satisfied 50% of all recorded consumption in 2004, but they lost 11 percentage points in consumption share in Georgia since. Wine claimed 9 pp, the biggest part of this spirits share’s loss, while beer claimed the rest 2 percentage points. For now, wine (43%) is the main source of consumed pure alcohol, followed by spirits (39%), and beer (18%) holds the third place.

With growing household income, demand for alcoholic beverages is expected to increase. In developing economies, income boost gradually translates into increased alcohol consumption in value. The World Health Organization (WHO) forecasts 10.5% gain in total (recorded and unrecorded) consumption of alcoholic drinks from 2020 to 2025 in Georgia. We believe this might positively impact the stagnant domestic wine consumption.

We believe that tourism will drive the domestic consumption of wine in future. The tourist expenditures on served food and drinks has increased by 2.3x from 2015 to GEL 2.27bn in 2019. Mainly driven by the number of visitors, the value also correlates with the increasing length of stay of the international visitor, up from 3.4 days in 2015 to 4.3 days as of 9M 2019. The Georgian National Tourism Agency further targets the average length of stay of 5.0 days by 2025. Tasting Georgian wine and cuisine is one of main tourist activities in Georgia. According to GNTA survey of 2018, 67% (4.4mln) of international visitors, named tasting Georgian cuisine and wine among the conducted activity, 2x more than that of 2015. The proportion increased to 74% in 9M 2019, from 66% in 9M 2018.

FIGURE 28: EXPENDITURES BY INTERNATIONAL VISITORS (GEL MLN)



Source: GNTA

FIGURE 29: TASTING GEORGIAN CUISINE AND WINE BY INTERNATIONAL VISITORS



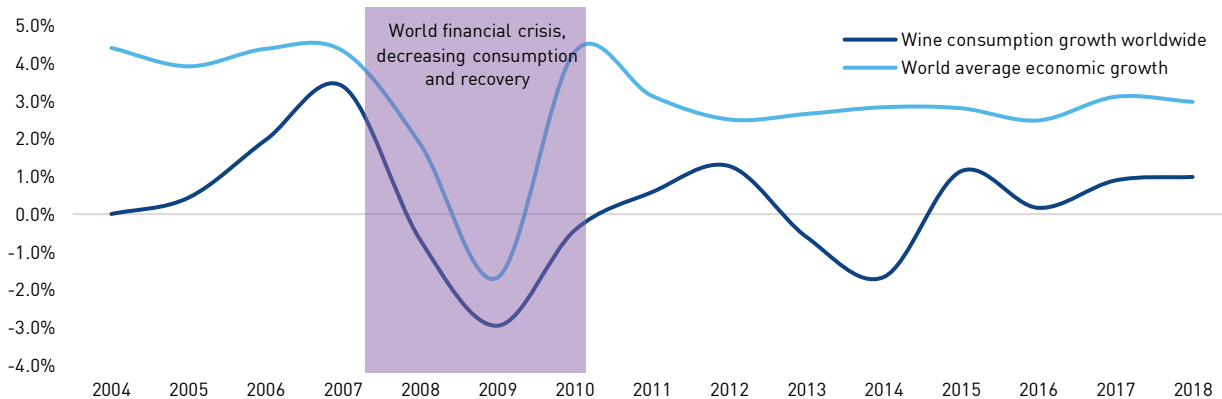
Source: GNTA

Wine Route Project supports the wine tourism development. The Wine Route Project by the Government of Georgia offers wine-tasting locations for tourists in different regions of the country. 91 out of total 164 are situated in Kakheti with Telavi, Gurjaani, and Kvareli municipalities having 30, 24, and 17 wineries respectively. Imereti has the second biggest stock of these destinations, 15 in total, with Shida Kartli and Racha-Lechkhumi & Kvemo Svaneti having 11 destinations each.

CONSUMER BEHAVIOR AND NICHE MARKETS

Stable economic growth signals wine producers to increase production. The correlation between economic growth and wine consumption worldwide exceeds 0.68 and demand fluctuates with economic cycles, accelerating with economic growth and falling sharply with recessions.

FIGURE 30: ECONOMIC AND WINE CONSUMPTION GROWTH WORLDWIDE 2004-2019



Source: OIV, WB, TBC Capital

International consumer trends that affect exports eventually will be mimicked domestically too. According to the Gallo Trends report regarding the US consumer, Millennials are four times more likely than older generations to select a bottle of wine based on its label. Millennials are looking for personality and originality in wine. Consumers are two times more likely to try something new in restaurants or bar than in retail stores. 43% of wine shoppers say that store tastings have a strong influence on what they buy and 73% say that they would enjoy a wine tasting class. 60% of wine drinkers prefer wine with little sweetness. 40% of alcohol beverage shoppers

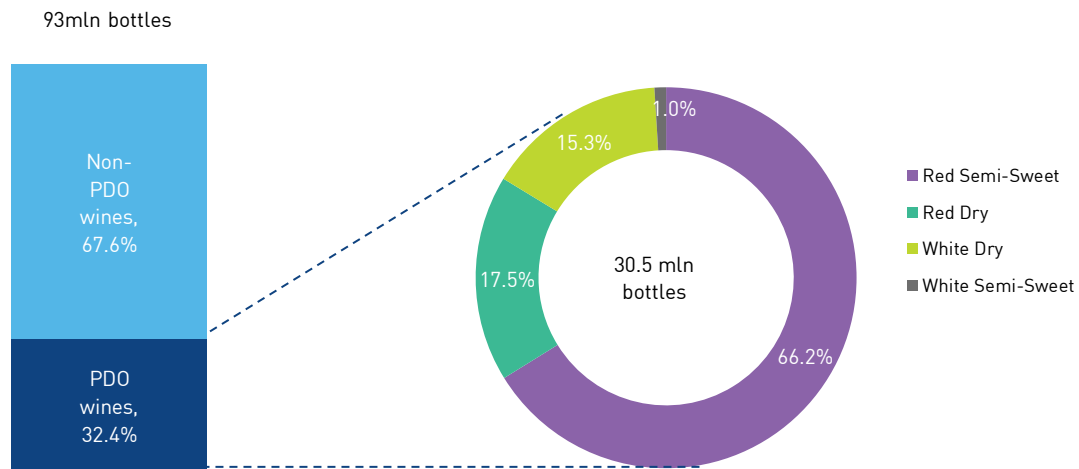
said they are likely to shop alcohol beverages online in the next year. 41% of wine consumers say they would buy wine in alternative packaging if they knew the wine was high quality.

Growing demand for quality rather than quantity of alcoholic beverages opens a new window of opportunity for niche products. On the domestic market, higher income individuals are increasingly consuming high-end wine, mainly sold by specialized shops and organized FMCG retailers in limited quantities. As for the international markets, consumers in developed countries (largely in EU) are more concerned with alcohol-related health risks, accumulating demand for quality products. With DCFTA, this could be an opportunity for Georgia, which has modest production capacity, but boasts with high quality grapes of endemic species.

PDOs and bio (organic) and naturalist wines target the niche markets. Currently, Georgia produces 20 PDO and 17 bio wines, mostly in Kakheti. Switching to bio-production is expensive and lengthy process for wine makers, incentivized by price. Due to higher price, we consider bio and naturalist wines more as an export focused products, while PDOs could fulfill the demand of premium segment on the domestic market as well.

PDO wines represent up to one third of the total wine export. In 2019, Georgia exported 93mln bottles of wine, of which 30.5mln bottles (32.4%) were PDOs. Three red semi-sweet wines (Kindzmarauli, Akhalsheni, and Khvanchkara) accounted for 66.2% of exported PDOs, followed by red dry (17.5%) and white dry wines (15.3%).

FIGURE 31: SHARE OF PDO WINES EXPORTED IN 2019



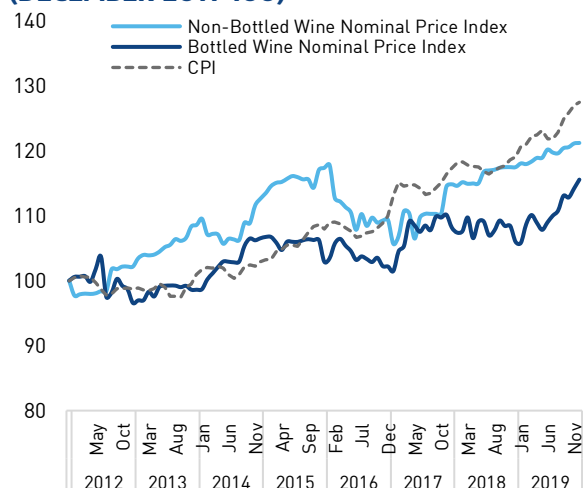
Source: GWA

Georgia has a great potential of positioning as boutique style exotic wine producer on foreign markets. Although low in production volume, wide variety of grape species could serve as an asset for making diverse style wines, with different level of sugar content and flavor, satisfying the niche market demand for exotic wines.

WINE PRICES: LOCAL MARKET

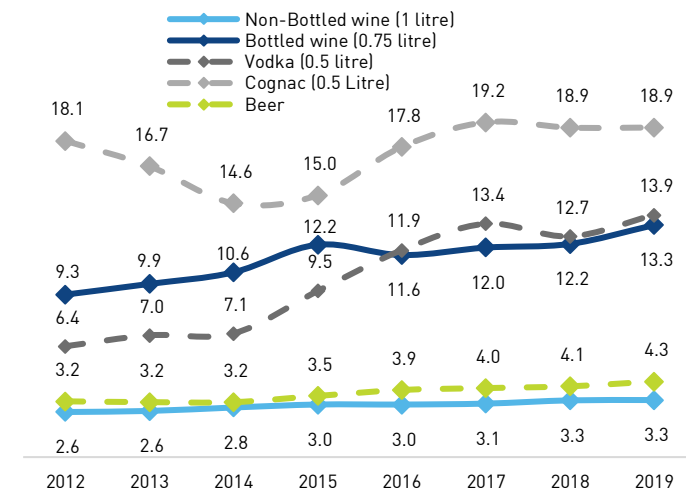
Domestic price for wine has been increasing slower than the general level of prices over the past years, with non-bottled wine price growing faster compared to bottled wine. This can be partially explained by the dwindling local consumption and intense price competition. From 2011 to 2019, consumer price index (CPI) grew by 27.4%, while bottled and non-bottled wine prices was up 15.5% and 21.2% respectively. The average retail prices for wine grew more than the index itself due to the changing mix of the marketed wines in favor of more expensive products, as well as the rising costs of production.

FIGURE 32: WINE DOMESTIC PRICE INDEX IN GEL (DECEMBER 2011=100)



Source: GeoStat

FIGURE 33: RETAIL PRICES FOR MARKETED WINE, GEL



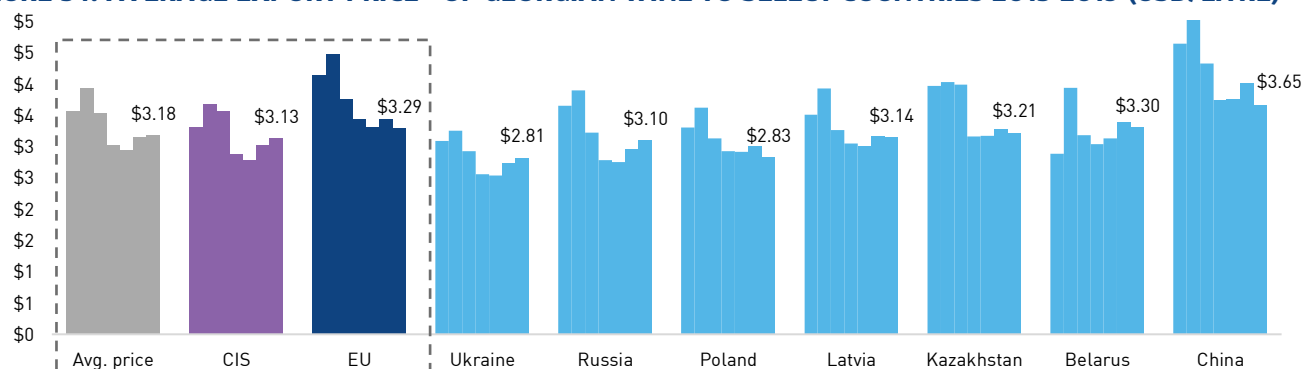
Source: GeoStat

Market shift to bottled wine affects the price dynamics. We believe that the supply side of the market is the primary reason for larger price gain of non-bottled wine compared to bottled wine. Seeking for higher margins, small-scale winemakers are switching to bottled wines, on the expense of reduced supply of non-bottled wine to the market.

WINE PRICES: EXPORT MARKETS

The declining USD price trend for exported Georgian wine has reversed. Average export price was up 7.0% YoY to USD 3.14 per litre in 2018, increasing somewhat less to USD 3.18 (+1.3% YoY) in 2019. While up in GEL, an average export price for Georgian wine is still down in USD compared to 2014. Compared to 2014, the average price of an exported litre of wine was down in 2019 by 19% in USD, while up by 14.7% in GEL. On a country level, the USA and Germany export markets are the most attractive in terms of price. Although, high prices express demand for high quality products in these countries, transportation and market entry costs should also be taken into account.

FIGURE 34: AVERAGE EXPORT PRICE¹² OF GEORGIAN WINE TO SELECT COUNTRIES 2013-2019 (USD/LITRE)

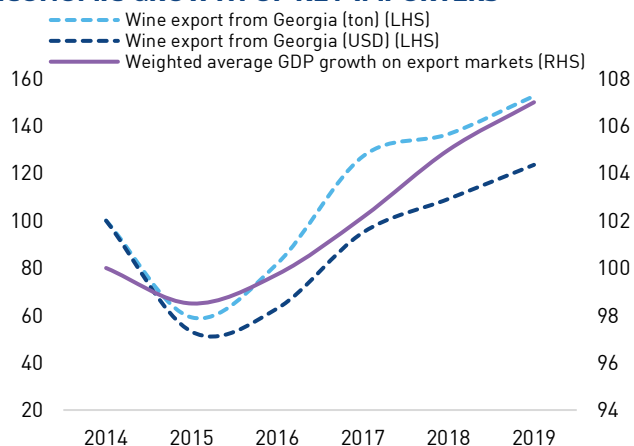


Source: ITC, TBC Capital

Economic state in trading partners majorly affects export volume and price of Georgian wine. Export price of Georgian wine decreased after 2014 with the currency crisis in main export destination countries, Russia and Ukraine. The weighted average exchange rate of main importing countries to USD displays high correlation (0.82) with the average export price of Georgian wine. For now, we observe export price picking up with the stabilized exchange rates in the trading partners. Besides, the volume and value of export proves to be highly correlated (0.94 and 0.87 respectively) with the GDP growth of the key trading partners.

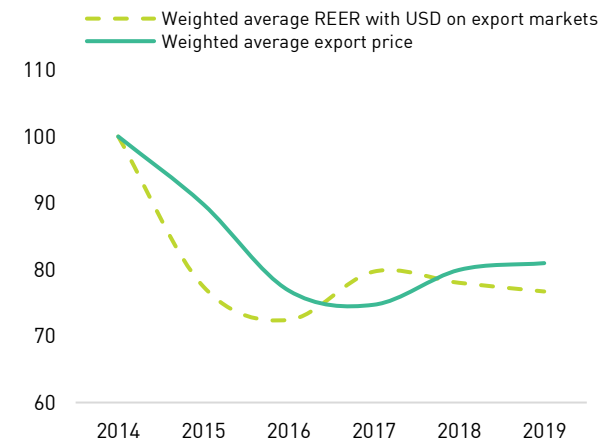
¹² Export is valued at FOB prices

FIGURE 35: GEORGIAN WINE EXPORT DYNAMICS VS ECONOMIC GROWTH OF KEY IMPORTERS



Source: GWA, GeoStat, NBG, TBC Capital

FIGURE 36: GEORGIAN WINE EXPORT PRICE VS EXCHANGE RATE DYNAMICS OF KEY IMPORTERS



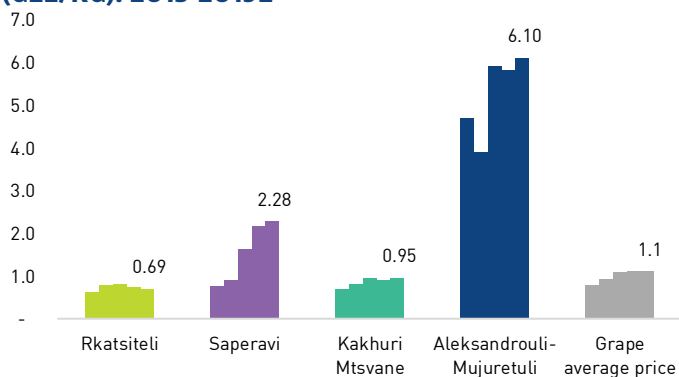
Source: GWA, GeoStat, NBG, TBC Capital

GRAPES PRICES

Grape prices change with international demand on Georgian wine. In 2014, before the economic crisis in Russia, and after the embargo lifted, the demand for grapes in Georgia was unusually high. To satisfy the demand and boost sales in Russia, Georgian winemakers purchased unusually big amount of grapes back in 2014 and had to pay high prices (1.25 GEL/kg) to grape producers. Since then, until 2019, export volume and grape prices moved in the same direction.

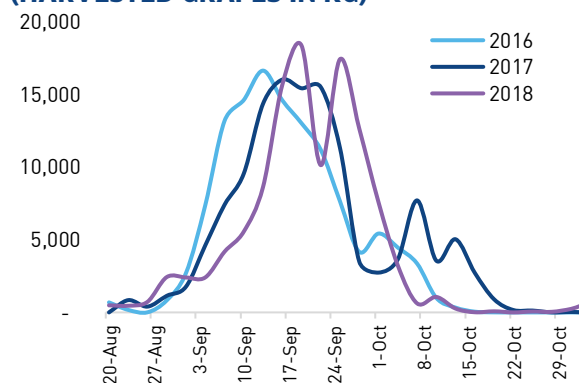
Grape prices stagnated in 2019. Thanks to the fruitful Rtveli 2018, Georgian winemakers have been able to satisfy the wine export demand and at the same time increase the stocks. Thus, the peak price level for grapes in 2019 was 48.3% lower YoY and the expected price for grapes for the year averages 1.11 GEL/kg (+0.9% YoY). Cheaper Rkatsiteli grapes mostly drove the price reduction. Rkatsiteli is mostly consumed domestically and is used in brandy production and we believe that this trend will not change in near future.

FIGURE 37: AVERAGE GRAPE PRICES BY SPECIES (GEL/KG): 2013-2019E



Source: GeoStat, TBC Capital

FIGURE 38: SEASON OF RTVELI 2016-2018 (HARVESTED GRAPES IN KG)



Source: GWA

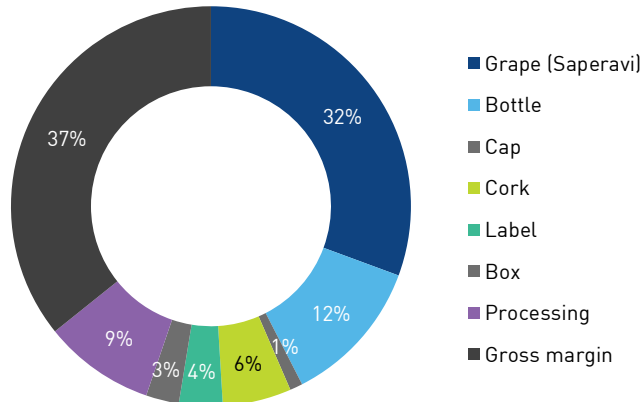
Saperavi prices are increasing steadily, as Aleksandrouli and Mujuretuli grapes benefit from the limited supply.

Since 2015, prices on the major grape species cultivated in Georgia had been increasing, but in the light of good harvest and abolished state subsidies in 2018, the growth halted into 2019. Nevertheless, with increasing export demand for red wine, Saperavi prices increased by 33.1% YoY in 2018. Price for Aleksandrouli-Mujuretuli averages 5-6 times higher compared to widely spread Rkatsiteli or Saperavi (94% of processed grapes in 2019) as the priors are used for producing high quality PDO wine Khvanchkara and in total only 1,848 tons (0.7% of all processed grapes) of these grapes were processed in 2019.

PRODUCTION VALUE CHAIN AND COMPANY FINANCIALS

For a typical bottle of wine, the grapes and the gross margin of the producer are the two largest components of the price. In case of the exported bottle of Saperavi, the grapes accounts for one third of the price. Processing grape into wine contributes to 9.3% of the value. Rest of the cost breakdown is labeling and packaging, which represents the quarter of the price, leaving 37.0% for the gross margin.

FIGURE 39: INDICATIVE BREAKDOWN OF PRODUCER'S PRICE – A BOTTLE OF SAPERAVI



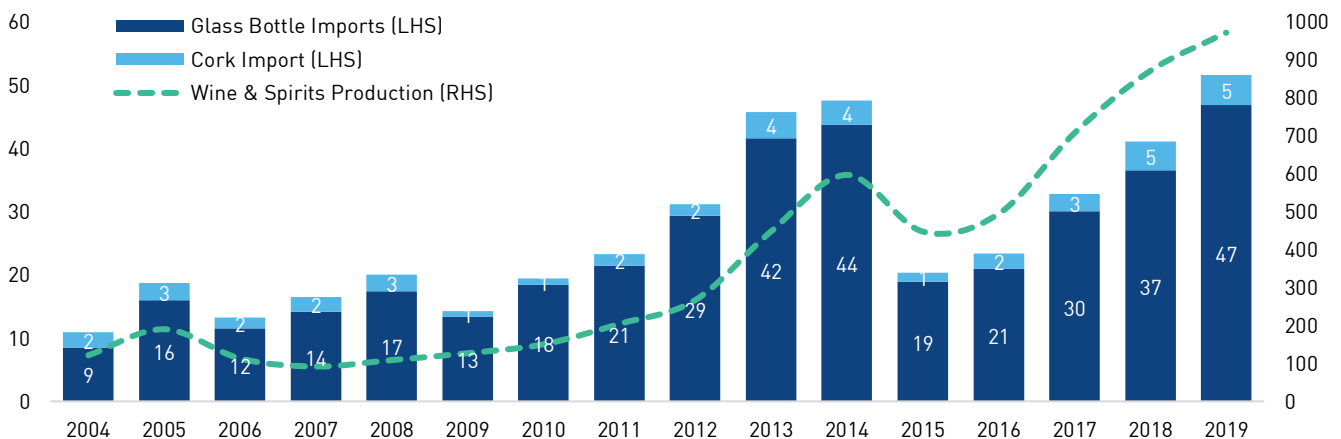
Source: TBC Capital Research

USD exchange rate appreciation drives up the COGS of Georgian wine producers. Georgian wineries import significant amount of packaging and other materials from abroad, hence the weaker national currency pushes COGS up. YoY growth in direct expenses as of 2019 would have reached almost 9% in USD terms.

Bottled alcohol production depends highly on imported glassware. Georgia imported 103 thousand tons of bottles, carboys, flasks and other glass containers in 2019, with total value of USD 46.8mln (+28% YoY). The only major local producer JSC Mina produces 5 thousand tons of glassware annually and has capacity to satisfy up to 40% of the market.

Nevertheless, Georgian glassware producers sell their products on international markets. In 2018, the country started to export glassware to France and the total exports exceeded USD 9mln (+75% YoY). Before 2018, Georgia exported glassware mostly to Azerbaijan and Turkey, value of which totaled USD 1.0mln and USD 4.5mln respectively, in the same year.

FIGURE 40: GLASS BOTTLES & CORK IMPORTS (USD MLN) vs WINE & SPIRITS PRODUCTION (USD MLN)



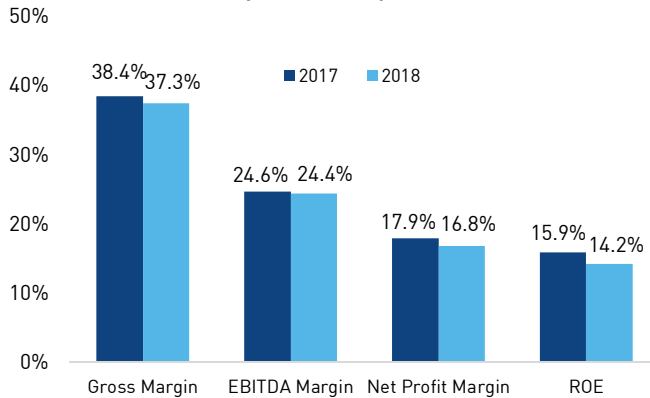
Source: GeoStat, ITC

Georgia imports a ready-to-use cork stoppers, rather than a raw material itself. The import dynamics of cork follows the wine production, increasing to USD 4.6mln (+64% YoY) in 2018. Processing of cork blocks into their marketable form is not a complex or expensive process, but the raw material required is unavailable in Georgia.

Selected wine producers display high profitability. We have analyzed financials of wine producers with total turnover exceeding GEL 550mln, which represents nearly 80% of the formal market¹³. Sector's average gross margin was down by 1.1 pp YoY in 2018, totaling 37.3%. EBITDA margin (24.4%), Net Profit Margin (16.8%) and ROE (14.2%) also decreased in the same period.

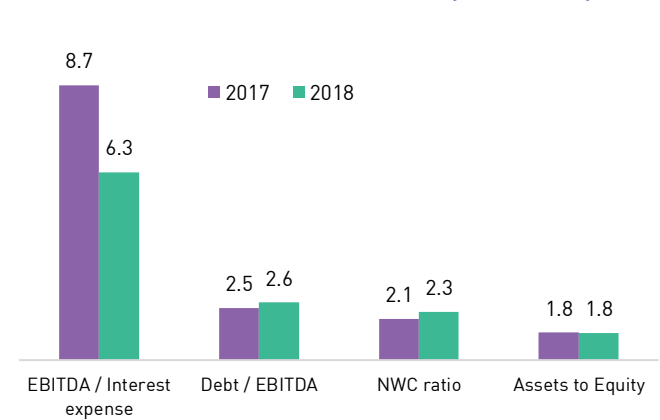
Low level and stability of sector's leverage underlines room for further growth. Liabilities accounted roughly 40% of wine producers' assets, while NWC ratio increased from 2.1 to 2.3 YoY in 2018. EBITDA/Interest expense and Debt/EBITDA was 6.3 and 2.6 in 2018, respectively, meaning the industry liquidity risks are low.

FIGURE 41: PROFITABILITY METRICS FOR GEORGIAN WINE PRODUCERS (2017-2018)



Source: SARAS, TBC Capital

FIGURE 42: SOLVENCY AND LEVERAGE METRICS FOR GEORGIAN WINE PRODUCERS (2017-2018)



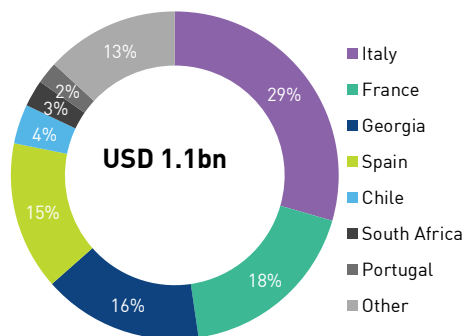
Source: SARAS, TBC Capital

DOMESTIC PRODUCERS: INCREASING EXPOSURE TO THE RUSSIAN MARKET

Georgia is the third largest exporter of wine to Russia, the twelfth largest wine importer worldwide. In 2018, Russia's wine import totaled USD 1.1bn, of which 16% originated from Georgia. Italy (29%), France (18%), Spain (15%) and Chile (4%) were the other four in the top five largest wine exporters to Russia by value.

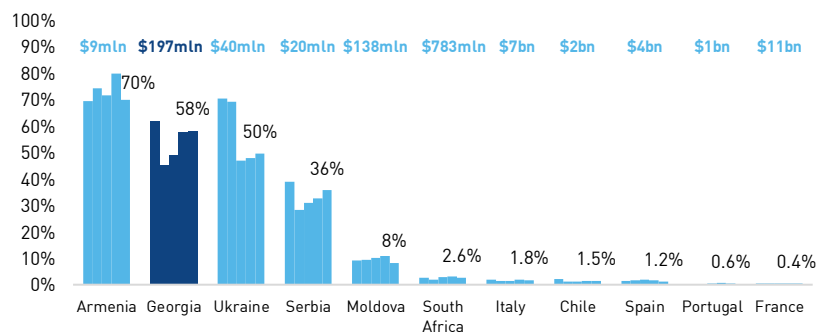
Georgian wine export diversification increased during the Russian embargo, but the exposure of the domestic wine sector to Russian market is still high and increases. All other wine exporters, but Armenia, that sends 70% of its small-scale wine exports to Russia, have lower exposure to the Russian market. In 2018, Georgia sold 58% of all its exported wine to Russia (60% in 2019), while the corresponding figure stood at 50% for Ukraine, 36% for Serbia, only 8% for Moldova. The exposure for the traditional or high-tech wine producers was even lower, ranging 0-3%. Familiarity to Georgian wines in Russia eases the export, but the current high exposure to single market encompasses higher risks for businesses in the long-term.

FIGURE 43: RUSSIA WINE IMPORT BREAKDOWN (2018)



Source: ITC

FIGURE 44: SHARE OF RUSSIA IN WINE EXPORT (2014-2018) AND TOTAL VALUE OF EXPORTED WINE IN 2018

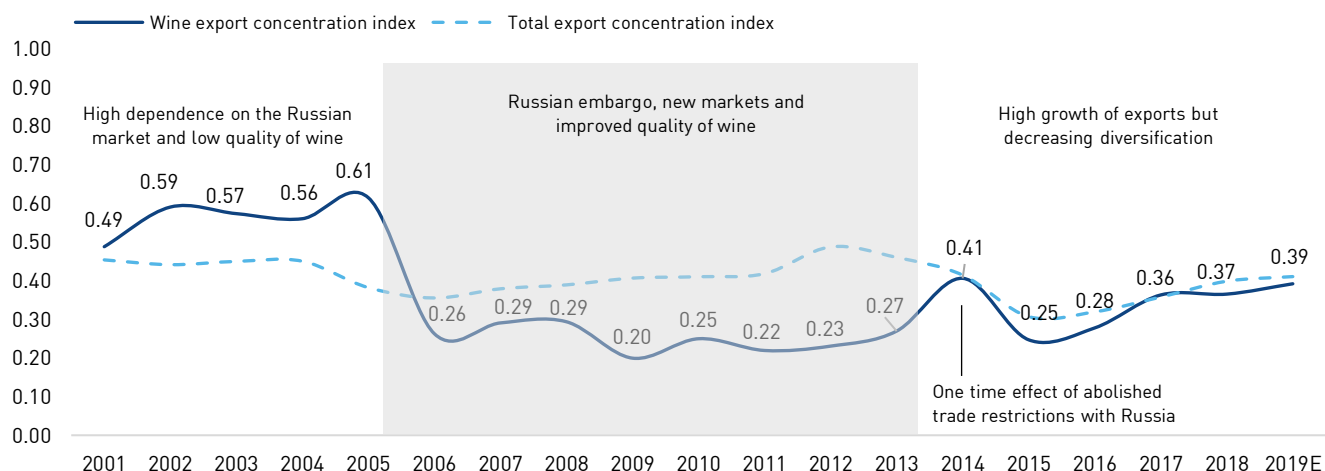


¹³ As of 2018

Russian embargo in 2006 forced Georgian winemakers to seek the new markets and modernize production.

Following the embargo, Georgian wine producers started to invest heavily to improve the quality to focus on markets with higher purchasing power, directing their products to European, as well as Asian markets. As Russia lifted trade restrictions in 2013, diversification decreased, but export concentrations remained below 2005 level. Overall, the political risks and low average export price of this particular market remain a challenge for the Georgia's wine industry in general. On the flip side, currently the sector is more resilient to potential downsides.

FIGURE 45: EXPORT CONCENTRATION INDEX¹⁴ BY COUNTRIES 2001-2019 (1.0=ABSOLUTE CONCENTRATION)



Source: FAO, TBC Capital

Hypothetically, the embargo would depress the profitability of wine producers but the industry can remain resilient below the dependency threshold of 30%. A hypothetical company with the dependency beyond this level might start experiencing the problems with debt service through operating cash flow.

Farmers producing grapes are more vulnerable to embargo than wine producers. Wine producers could decrease production costs by purchasing lower amount of grapes and smooth the negative effect from decrease in sales but farmers will need subsidies from the government to compensate losses and remain resilient.

TABLE 4: STRESS SCENARIO FOR EMBARGO AND PROFITABILITY AND LIQUIDITY METRICS FOR GEORGIAN WINE PRODUCERS

Loss of sales	Base scenario	Wine producer 1	Wine producer 2	Wine producer 3	Wine producer 4	Wine producer 5
	Without embargo	With embargo				
	0%	-20%	-30%	-40%	-50%	-60%
Gross Margin	37.3%	35.1%	33.5%	31.4%	28.4%	23.9%
EBITDA Margin	24.4%	20.9%	18.5%	15.2%	10.7%	3.9%
Net Profit Margin	16.8%	11.6%	7.8%	2.7%	-4.3%	-14.9%
ROE	14.3%	7.8%	4.6%	1.4%	-1.8%	-5.0%
ROA	8.1%	4.4%	2.6%	0.8%	-1.0%	-2.9%
DEBT / EBITDA	2.62	3.80	4.92	6.96	11.91	41.21

Source: SARAS, TBC Capital

¹⁴ Index calculations follow the Herfindahl-Hirschman Index (HHI) calculation methodology.

TABLE 5: SWOT ANALYSIS OF THE WINE INDUSTRY

	Factor	Comment
STRENGTHS	Unique wine varieties and tastes	525 endemic grape varieties are found in Georgia, of which 30 are cultivated commercially and 20 PDO wines are produced.
	Reputation for 'Cradle of Wine'	The oldest wine region in the world, acknowledged by UNESCO.
	Experience in export	Wine is the fourth largest export product countrywide, while Georgia is in Top 20 countries exporting wine worldwide. In 2019, Georgia exported 94mln bottles of wine, with total value of USD 223mln.
	Strong financials	Profitability metrics stand high in the wine sector. Gross Margin 37.3%; EBITDA Margin 24.4%; Net Profit Margin 16.8%; ROE 14.3% in 2018.
WEAKNESS	Lack of diversification	Share of Russia in Georgia's wine export stood at 60% in 2019. Of countries exporting wine to Russia, the exposure is higher only for Armenia with insignificant exports.
	Low vineyard productivity	5.2 tons of grape cultivated per ha on average, 8.5 ton/ha for large-scale producers.
	Only two species of grape make up almost all production	Rkatsiteli and Saperavi account over 90% of grape production in the country, while other unique varieties with high export potential and financial returns have lower share in production.
	Limited production capacity	Limited supply of vineyards, mostly owned by small-scale farmers (95.4% own less than 1ha area as of 2014 census).
	Fragmented production	Circa 390 small-size wine producers; No economy of scale; Share of large companies in wine & spirits sector turnover at 28%.
OPPORTUNITIES	Investing in technology	Usage of modern cultivation techniques in viticulture, new vineyards and high quality irrigation systems will lead to increased vineyard productivity.
	Mergers and achieving economies of scale	Merging with other wineries for more efficient production and increasing scale of vineyards will lead to increased capacity and the economies of scale.
	Targeting new export markets	With increasing recognition of Georgian wine through promotion and free trade arrangements, Georgian winemakers could enter new foreign markets, characterized with higher purchasing power and consumer taste for wines similar to Georgian.
	Demand from tourists	Rapid growth of international visitor trips in the country and high interest in Georgian wine among tourists will drive local consumption.
	Increasing penetration of formal market locally	Homemade, non-bottled wine, which captures a great portion of the local market, can be partially substituted by bottled wine, as consumer behavior slowly changes.
THREATS	New embargo	Regional instability and high dependency on single export partner remain a key challenge for Georgia's wine sector.
	Spread of pests, hail and disasters	Unfavorable natural conditions encompass a significant threat for the harvest, as many farmers do not have agro insurance.

SPIRITS: BRANDY PRODUCTION ON THE RISE

Production of brandy and other spirits are expected to hit the record high in 2019, reaching GEL 258mln (+10.7% YoY) in value. As Brandy is made by distilling wine, production can be switched between the two, if the wine sales are dwindling. This strategy was utilized during the Russian embargo, when production of Brandy increased sharply from 2006 to 2013 and declined after. The volume of spirits production surged by 10.6% in 2018, and is expected to increase by marginally in 2019, to 2.5mln decalitres. Among the incentives for the local producers are the growing exports, growing wine production creating the resources for spirit production as a by-product, the growing popularity of Georgian chacha among tourists, and increasing interest for cocktails among locals. Since 2016, still with small-scale production, whiskey is a new addition to Georgian alcoholic drinks assortment.

The availability of wooden cask stocks in Georgian wineries supports production of brandy and other spirits in the country. Previously used for aging wine, wooden cask is essential for producing brandy, whiskey, and other alcoholic drinks. Hence, wineries represent the common base for brandy and whiskey production in Georgia.

FIGURE 46: PRODUCTION VOLUME (MLN DECALITRES)

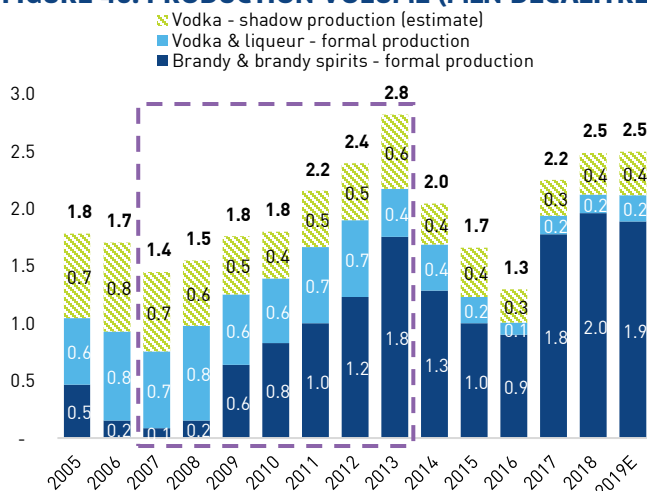
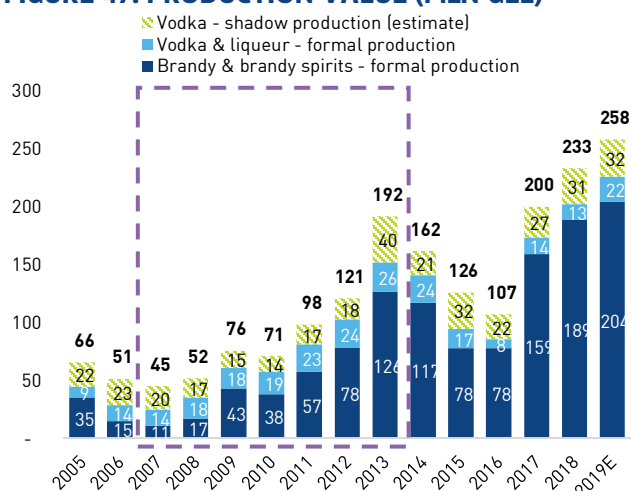


FIGURE 47: PRODUCTION VALUE (MLN GEL)



Source: GeoStat; Note: Formal production value of spirit is somewhat less than spirit producer company turnover, as they have additional revenue streams.

Georgian brandy producers have diversified export markets. Brandy exports reached USD 106.5mln (65mln litres) in 2018 and is expected to reach USD 107.9mln (+1.3% YoY) in 2019. The largest export market is Ukraine, constituting broadly 30% of total exports in both 2018 and 2019. Overall, the export market for Brandy has a different structure compared to wine. The producers of brandy are less concentrated on the Russian market. The traditional wine making countries like France (18%) and Spain (11%) are expected to be among the Top 5 export destinations in 2019.

FIGURE 48: EXPORT BY COUNTRIES (USD MLN)

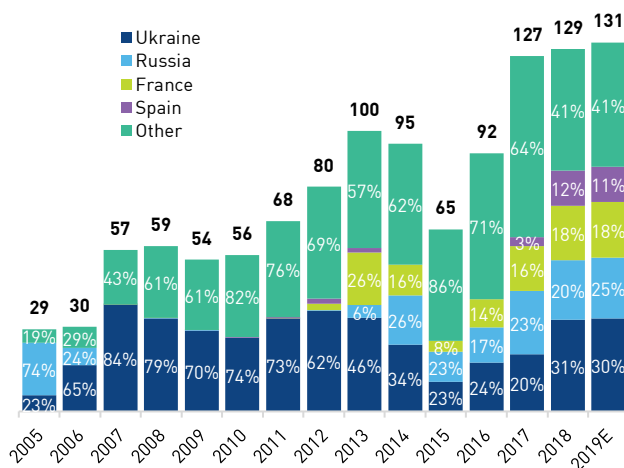
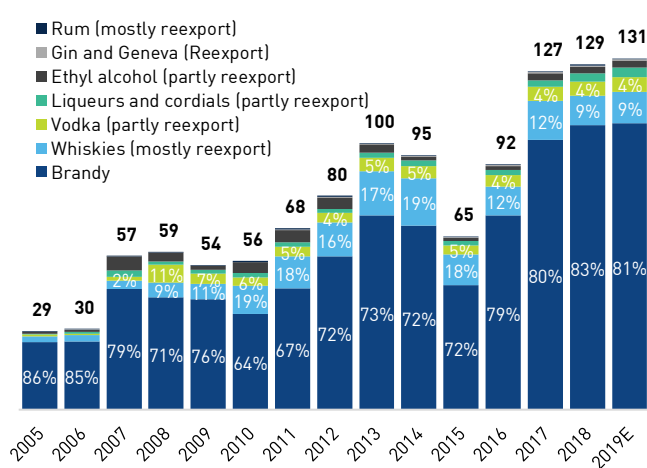


FIGURE 49: EXPORT BY CATEGORY (USD MLN)

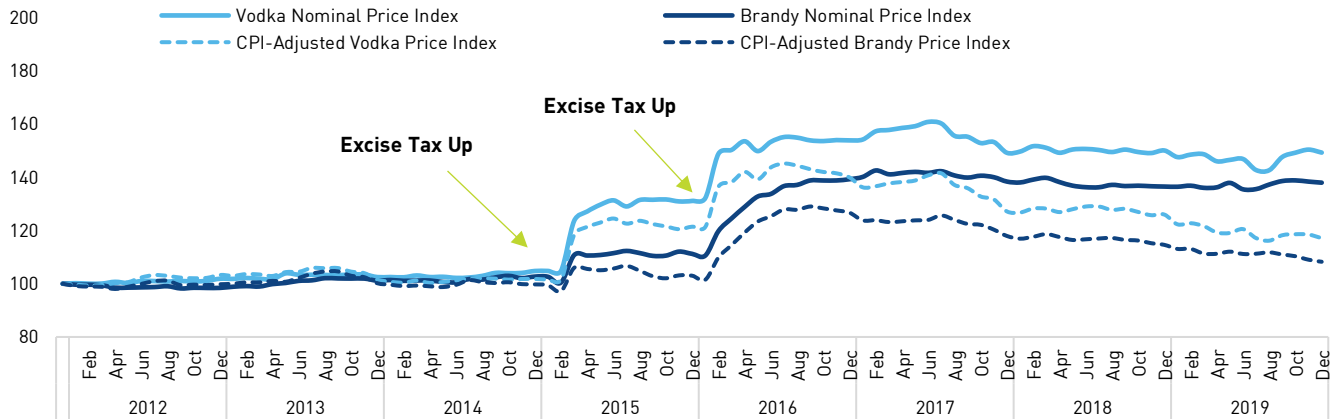


Source: ITC; Note: Production value of spirit is less than spirit exports, due to re-export and changes in stock

Average adult consumes less than 8 litres of spirits annually in Georgia. According to the latest estimates by WHO, the per capita consumption was slightly down to 7.5 litre in Georgia, but it still exceeded the corresponding figure of the EU, 6.8 litre per adult. Consumption in Georgia fell behind Ukraine (7.9 litres), Armenia (8.2 litres), Russia (8.6 litres), but was much higher than in Azerbaijan (0.5 litres) and Turkey (1.2 Litres). Average alcohol concentration equals 38% per litres of spirit.

Excise tax reform affected prices for spirits on the domestic market. In the beginning of 2015, in response to increased excise tax on strong spirits, prices for vodka and brandy spiked. Vodka prices increased by 25.3% YoY, while brandy prices increased by 8.6% YoY and fully absorbed effects of the new regulation within 9-months. Vodka added 23% to its prices in half-year time, and brandy added 9% in the same period.

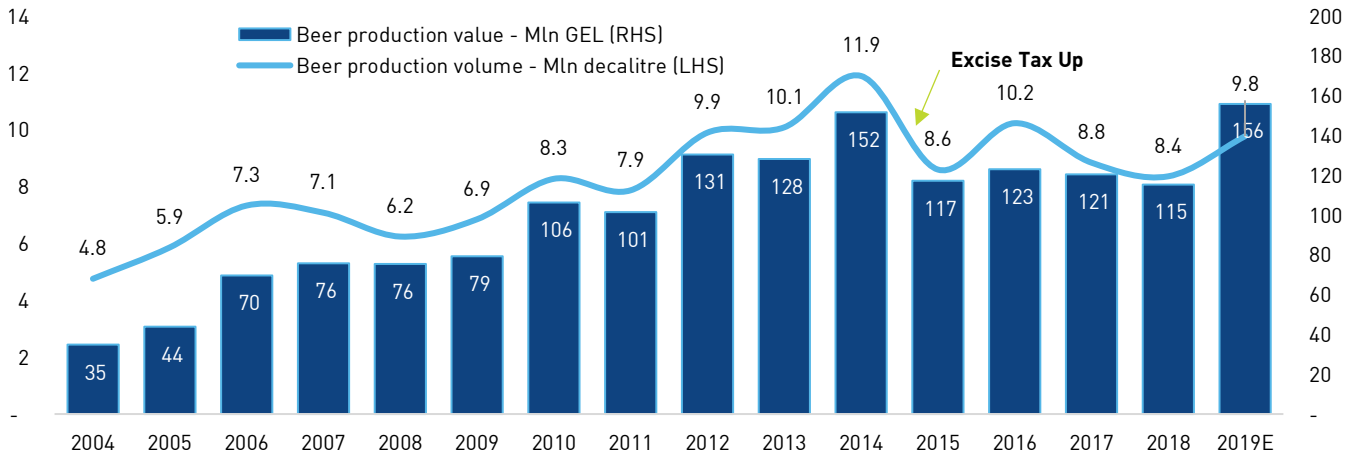
FIGURE 50: SPIRITS DOMESTIC NOMINAL AND CPI-ADJUSTED PRICE INDEX IN GEL (DECEMBER 2011=100)



BEER: REBOUNDING FROM SLOWDOWN ON ACCOUNT OF EXCISE TAXES

Beer production has been rising after three years of decrease. Beer production had an upward trend during 2005-2014 and doubled in volume to 11.9mln decalitres (GEL 152mln value) in 2014. Excise taxes and consumer sensitiveness to higher prices decreased the production in the post-excise-tax-reform years to 8.4mln decalitres in 2018. Expected production for 2019 equals 9.8mln decalitres of beer with total value of produce estimated at GEL 156mln.

FIGURE 51: PRODUCTION OF BEER – VALUE AND VOLUME



Source: GeoStat

Georgian breweries’ turnover has been increasing since 2016. More than five-fold increase in exports (in GEL terms) from 2015 to 2018, paired with 11% hike in prices in the same period, compensated reduced consumption of beer in litres in Georgia. Although we expect the exports of beer in 2019 to be down YoY, due to the price effect and recovering consumption in the country, Georgian beer producers’ turnover in 2019 is expected to reach GEL 284mln (+6.5% YoY).

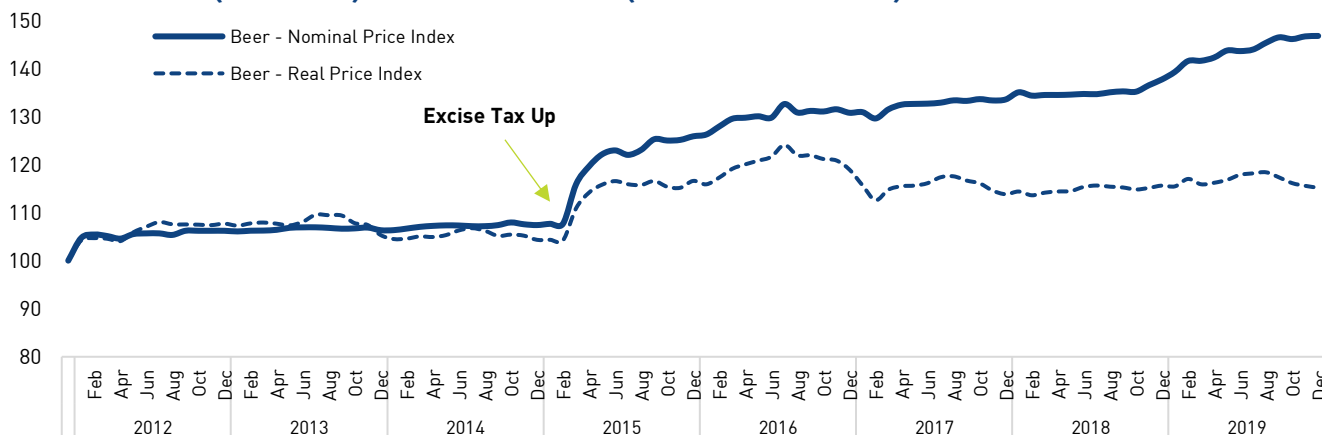
Thanks to high quality water, Mtskheta municipality is a preferred area for industrial beer production facilities. Water, suitable for beer production, is abundant in surroundings and even represents a unique selling proposition for some of domestic brands. Another advantage of Mtskheta municipality is its proximity to Tbilisi, to the biggest market in the country. Major producers, like JSC Georgian Beer Co. (produces 20mln decalitres of beer & soft

drinks annually), JSC Lomisi [Efes Georgia] (production capacities 10mln decalitres of beer annually, sales of 1600 decalitres in 2018), and Global Beer Georgia (produces 0.05mln decalitres annually), base their production capacities in Mtskheta municipality (Saguramo, Natakhtari, and Tsilkani, respectively).

More than 20 world-renowned beer brands are produced in Georgia. The internationalization of Georgia’s beer production started in early 2000s and, at the moment, four Georgia-based companies produce brands owned by world beer market leaders like Efes, Carlsberg, or Heineken. German, Belgium, Dutch, and Czech beer brands prevail, but domestic producers also produce (or have license to produce) beer originated from five other countries too. This creates an opportunity for domestic breweries to meet the tastes of wider range of domestic consumers, and pocket additional profits. Furthermore, Georgian breweries can expand their sales on neighboring markets, like Armenia, where collaborations with named international producers are less developed, or Azerbaijan, where beer represents more than 60% of alcohol beverage consumption.

The excise tax raise had the largest impact on beers with higher alcohol concentration. Beer was an object to tax reforms in two instalments. In the beginning of 2015, doubling the excise tax on beer resulted in +17% price increase throughout the year. The second stage of excise tax reforms applied to beer in July 2017, when the method of excise tax calculation changed. According to the new regulation, each percent of alcohol in beer is a subject to GEL 0.12 excise tax, thus softer beer benefited more.

FIGURE 52: BEER (DOMESTIC) PRICE INDEX IN GEL (DECEMBER 2011=100)

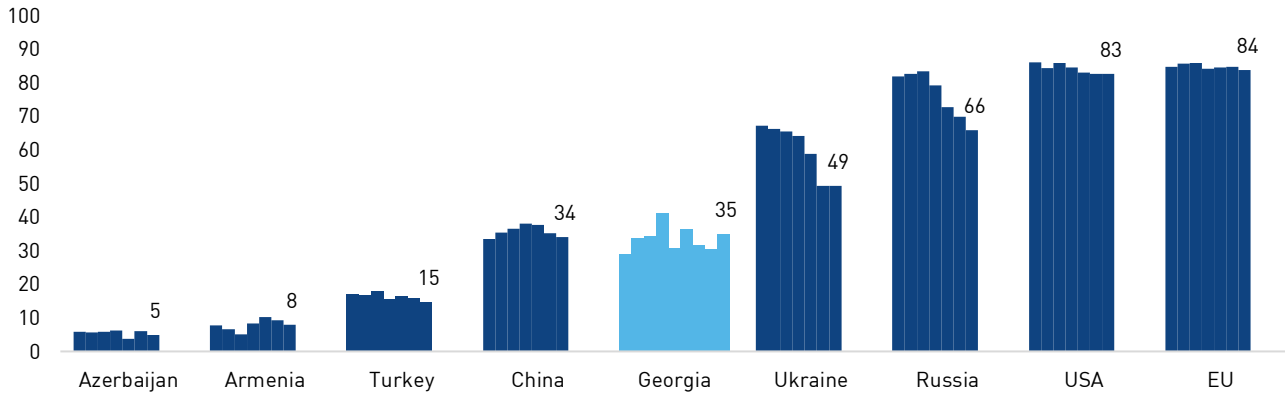


Source: GeoStat, NBG, TBC Capital

Local beer producers depends on the domestic demand, rather than foreign. For ten years from 2004 onward, beer production, generally, had an upward trend and the correspondence was step-by-step changing in favor of value compared to the volume of production. Consequentially, in 2014, the record year for Georgian breweries, beer production reached GEL 152mln in value (2.5 times more than in 2004) and 11.9mln decalitres in volume (4.4 times more than in 2004). Beer consumption has a consistent seasonal pattern. Summer season captures 40% of annual production and sales, while only 15% of the beer market activities happen in winter. Ready-to-drink market is growing and the average volume of the bottle sold reduces by 0.7% YoY depicting this change in the sales mix.

Georgia consumes less beer per capita compared to other countries. According to the latest estimates by WHO, Georgia’s annual per capita consumption of pure alcohol in beer form (1.25l) is only 38% of what a typical EU citizen consumes in a year (3.30l). Beer consumption in neighboring Russia and Ukraine is also higher, totaling 3.50l and 2.51l per capita respectively.

FIGURE 53: ANNUAL BEER CONSUMPTION (LITRE PER CAPITA) IN 2010-2019*



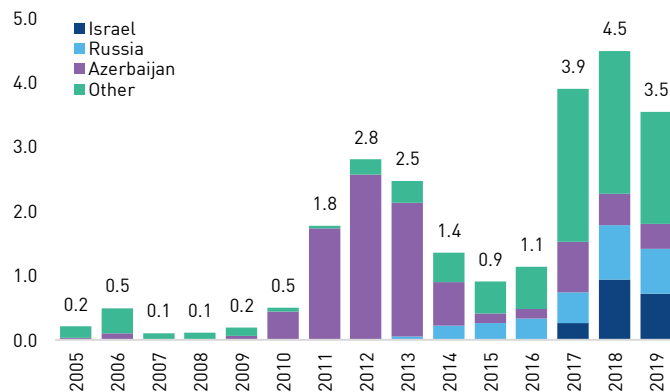
Source: WHO, TBC Capital; Note: Average alcohol concentration equals 5% per litres of beer; Georgia 2010-2019, other countries 2010-2016

Georgian breweries turned to foreign trade markets, slightly compensating losses on the domestic market.

Although modest in absolute terms, beer exports skyrocketed in 2017 (USD 3.9mln) and increased further to USD 4.5mln in 2018. However, more than half of beer export in 2018 was actually re-export. Beer export is rather diversified and its geography widens. Azerbaijan was almost a sole importer of Georgian beer until 2013 with c. 90% of the export share in 2010-2013. In 2018, the share was down to 11%, with Israel and Russia accounting for 21% and 19% of Georgia’s beer export, respectively. These two countries are expected to be the biggest importers of Georgian beer in 2019 too, accounting for 39% of total beer exports of the country.

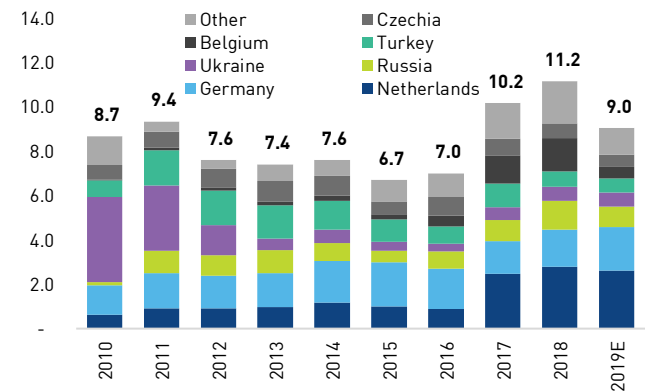
Georgia imports beer in small quantities but from different markets. In 2018, 22 countries exported beer to Georgia and the number of suppliers increased by one in 2019. Netherlands (29%), Germany (22%), and Russia (10%) are leading the imports with combined import value expected to reach USD 5.2mln in 2019. On the other hand, the imports from Belgium (6%) fell sharp since 2018. In addition, note that the popularity of Mexican beer, not available on the local market before 2009, grew steadily until 2018 and the import value neared USD 1.0mln, but the imports are expected to be down to USD 0.3mln in 2019.

FIGURE 54: BEER EXPORT (USD MLN)



Source: GeoStat, UN Comtrade

FIGURE 55: BEER IMPORT (MLN USD)



Source: GeoStat, UN Comtrade

ACRONYMS AND ABBREVIATIONS

BN, bn	Billion
CAGR	Compound Annual Growth Rate
CIS	Commonwealth of Independent States
COGS	Cost of Goods Sold
DCFTA	Deep and Comprehensive Free Trade Area agreement
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
GEL	Georgian Lari
GeoStat	National Statistics Office of Georgia
GNTA	Georgian National Tourism Agency
GWA	National Wine Agency of Georgia
HA, ha	Hectare
HII	Herfindahl-Hirschman Index
HL, hl	Hectolitre (100 Litre)
HoReCa	Hotels, Restaurants and Cafes
IRR	Internal Rate of Return
ITC	International Trade Centre
JSC	Joint-stock company
L, l	Litre
MLN, mln	Million
NBG	National Bank of Georgia
OIV	International Organization of Vine and Wine
PDO	Protected Designation of Origin
pp	Percentage Point
SARAS	Service for Accounting, Reporting and Auditing Supervision
UK	United Kingdom
UN Comtrade	United Nations International Trade Statistics Database
UNESCO	United Nations Educational, Scientific and Cultural Organization
USA	United States of America
USD	United States Dollar
WB	World Bank
WHO	World Health Organization
YoY	Year over Year

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