

Springtime in the Fall Georgia, Romania & Slovenia

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With a quick glance at the photo, we might be in any European city in springtime. The buildings are classical, the sidewalks are wide, café chairs are out, and the tourists are dressed lightly. Yet there is fall color in the trees. This is November, but where? Perhaps Italy, from the tall slender cypress rising behind the hotel on the left?

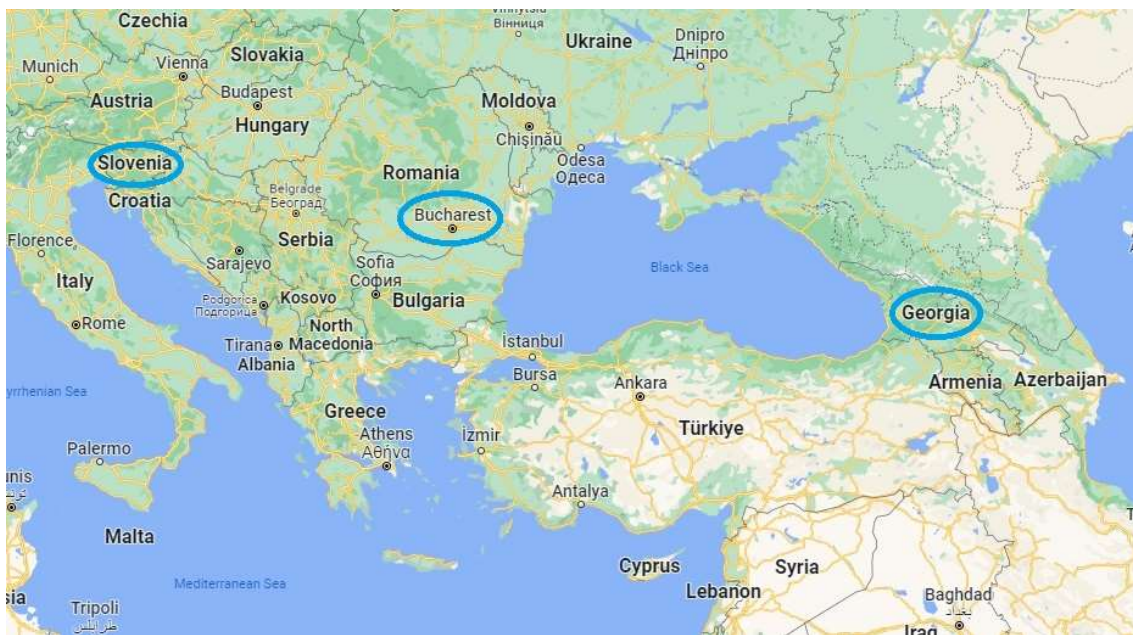
A good guess, but this is Tbilisi, a lovely city in the lovely country of Georgia.

The hotel on the left is the Majestic, built in 1915, turned into a hospital in WWI and occupied by the Soviet Labor Committee in the 1920s. It was shot at in the civil war in 1991, and finally turned back into a hotel in 2002.

The unseasonably warm weather may be due to global warming, but there are signs of spring in financial markets as well, after the long winter of COVID and inflation. On this research trip to Georgia, Romania and Slovenia there was optimism in the air. Inflation is coming down from double to single digits, and interest rates may do the same. Perhaps a global recession won't be as bad as feared. And the consumer may be ok because of savings built up during social distancing.

The trip wasn't all fun, with a 7-hour layover in Vienna, a delayed flight on Georgian Air (that did not include any paper products in the lavatories) and a 2 am departure from the hotel in Tbilisi to catch flights through Istanbul to Bucharest. But it was worth it, both for the information and the experience.

Overall, I am optimistic. The banks may be able to sustain margins if interest rates don't fall too suddenly. And I believe that deficit plagued governments may not go on imposing unexpected taxes forever - like the Fiscal Law Package (Romania), the "Solidarity Tax" (Romania) and the flood reconstruction tax (Slovenia) and the 0.2% windfall tax on bank assets (Slovenia). I am also optimistic that there may be a long-awaited rotation of investment flows out of the US market into EAFE, emerging and frontier markets, such as the three on this trip.



Of the three countries, Slovenia is the richest, and it feels similar to Western Europe in cleanliness, politeness and efficiency.

	2022 Georgia	2022 Romania	2022 Slovenia	2022 Germany	2022 Vietnam
GDP Growth	10.1%	4.8%	5.4%	1.8%	8.0%
GDP / cap (PPP)	\$20,113	\$41,888	\$50,032	\$63,150	\$13,457
GDP / cap (PPP) 5 yr Growth Rate	13.6%	16.3%	10.8%	7.0%	14.9%
Population (mil)	3.7	19.0	2.1	84.1	98.2
% Literate Female	100%	99%	N/A	N/A	95%
Infant Mortality < 5 yrs/1,000	10	6	2	4	21
% Urban	60%	54%	56%	78%	39%
GINI Index	34	35	24	32	37
Electricity/cap kWh	2,694	2,584	6,728	7,035	1,431
% Banking Penetration	71%	69%	99%	100%	56%
Market Cap (\$ bil)	\$3.5	\$25.5	\$8.4	\$2,284.1	\$186.0

Source: World Bank WDI, 2023

Tbilisi in Georgia is to the east of Ukraine, but it feels western. In fact, relative to Moscow, Tbilisi is 200 miles east and 1,000 miles south. Meanwhile in Tbilisi, historic buildings are being restored, and people seem happy, especially the young kids we met at a school.

Bucharest, Romania, is gritty and had the worst traffic of the trip. There are many old buildings that should be restored but are boarded up because of corruption issues over securing a proper title.

After ten flights in 8 days (counting an unscheduled sleepover at O’Hare), I have increased confidence in the region. We own a good selection of companies, including banks with ROEs above 20% and strong Net Interest Margins thanks to the recent European Central Bank’s rate hikes. Also, we have some new ideas that warrant further work.

Georgiaⁱ

Georgia is one of the few beneficiaries of the Ukraine War. It was once a major transit point on the silk road, and now it is a strategic transit point again because of cargos that avoid Russia. The economy has grown at a double-digit rate due to trade.

And there has been a reverse “brain drain” with the arrival of nearly 200,000 Russians and Ukrainians, many with jobs working remotely and with money to spend. At the same time, tourists are returning to see the old town and fort in Tbilisi as well as the nearby mountains for hiking and skiing.

The local stock market is moribund, but there is a total of three quality companies listed in London: TBC Bank (TBCG), Bank of Georgia (BGEO) and Georgia Capital (CGEO).



TBC Bank, Tbilisi

In addition to a big stake in BGEO, CGEO is a major operator of hospitals and schools. A visit to the Caucasus Medical Center revealed a major opportunity for improvements in health care. Patients lined the corridors of the old building which dates from Communist times, while outside many patrons lit cigarettes immediately upon walking out.



The Green School, Tbilisi

A more positive opportunity was seen at the Green School, a private school for K through 12, where tuition is below \$3,000 (USD). Although the building dates from Communist times, it was beautifully

remodeled over four months last summer. In one room, students practice English by watching a large screen monitor with the words of “It’s beginning to look a lot like Christmas”, being sung by Perry Como. Down the hall is a large swimming pool with kids paddling away.

CGEO has seven school campuses with 6,000 students, and its target is 20,000 students in a few years.

Given its proximity to Russia and Russia’s invasion of two northwestern provinces in 2008 (18% of Georgian territory), the government needs to carefully balance its relationship with Russia versus the West. The people, however, are strongly pro-Western. Georgia is expected to be granted EU Candidate status in December 2023.

After a full day, I was glad I didn’t turn down a dinner with the Georgia Capital team at the Barbaristanⁱⁱ restaurant with its famous 19th century Georgian dishes. There are times when it’s ok to get only 3 hours sleep before catching a 5 am flight through Istanbul to Bucharest.

Romania

In addition to smoking at least as much as Georgians, Romanians feast on foods of dubious health benefits. Fortunately, the Burgr Factory has not yet opened in the US, and I was at least able to get my burger in a “healthy” wrap.

The Bucharest stock market is sizeable, with more than a dozen investible companies. The largest by market capitalization is Hidroelectrica, a green utility that was listed in November. Hydropower generates 30% of electricity in Romania and nuclear, another 20%.

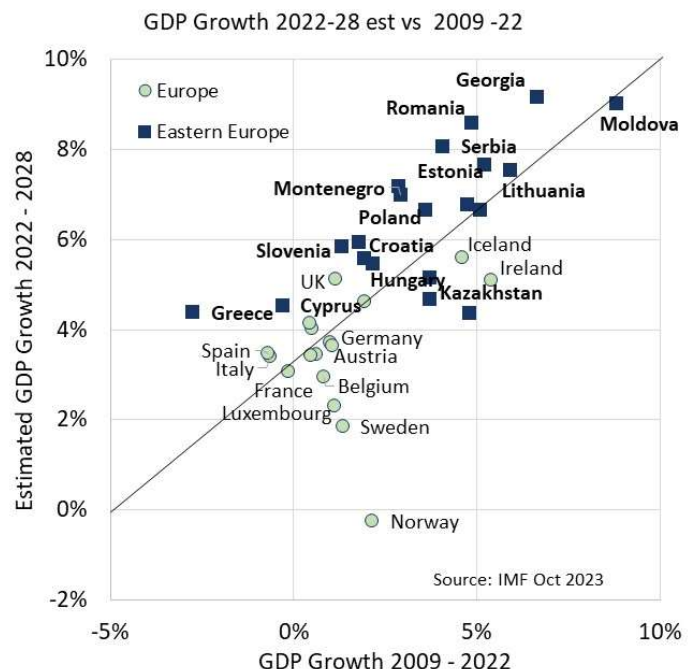
Petrom is the second largest company in the market, 51% owned by OMG in Austria and 21% owned by the government. It is a fully integrated oil and gas company with a major plan to move into green energy. Also, a new gas development in the Black Sea should come on stream in five years. Meanwhile, cash is 40% of shareholders’ equity suggesting a continuation of special dividends, offering the potential of a double-digit yield.

Among other companies in the market, a local operator of hospitals, clinics and labs has just introduced drone delivery for lab samples.

Unfortunately, the government is struggling with a fiscal deficit that is above the European Union (EU) target of 3%. The deficit reached 9.1% in 2020, fell to 5.8% in



Burgr Factory, Bucharest



2022 and is expected to be 5.5% in 2023. There is concern that failure to manage the deficit could lead to suspension of EU funds, so the government is looking for money wherever it sees easy targets - such as the banks.

The new Fiscal Law Package, enacted overnight rather than with the required six-month delay, imposes a 2% tax on all banks revenues in 2024 and 2025, falling to 1% in 2026. In theory the tax will be gone in 2027. Meanwhile, the result is a 10% penalty to bank profits.

In addition, the government has imposed a tax on energy companies, including even taxing Petrom on energy products it uses in its own refineries.

And then there is a highly publicized long sought capital gain tax on Banca Transylvania (TLV) for the difference between its purchase price and the book value of Volksbank. TLV bought the bank at 0.5x book in 2015, one month before a law clarifying that such gains are non-taxable. Although litigation continues, the odds are that TLV will lose.

Despite the political impediments, Romania is an attractive investment destination, with the banks having double digit ROEs. As the chart of IMF data on the previous page shows, Romania is one of the fastest growing countries in greater Europe. It, along with Georgia and Slovenia are also among the countries with faster expected growth from 2022 to 2028 than in the prior period from 2009 to 2022.

Slovenia

It is a smooth drive east from Ljubljana airport (pronounced “loo-blee-aa-nuh”). The superhighway winds through green hills with snowcapped mountains of the Alps to the north. After an hour, we arrive at the town of Novo mesto, with the factory of Krka looming above it, like a medieval castle above a feudal village.

In fact, there are no vassals here. Krka, one of only two Slovenian stocks traded in London, is one of the world’s leading generic pharmaceutical companies. Despite having 23% of its sales in Russia, Krka has survived the Ukraine war quite well thanks to factoring of its receivables by Russian banks, who also “take care of collections”.

With sales throughout Europe, Krka has an excellent reputation for quality.

Krka also owns Term Krka, a chain of spas including the Grad Otočec Castle Hotel, a member of the Relais & Chateau chain. It was here that Krka concluded their Investor Day for



Cankarjevo nabrežje riverside, Ljubljana

analysts with a six-course dinner.

The other London-listed company in Slovenia is Nova Ljubljanska Banka (NLB) which has a dominant position in the Balkan banking with half its business in high-margin retail lending.

After a stay in the old town, NLB's headquarters in the Communist era Republic Square is drab, but the view from the top floor observation deck is superb, showing the compact size of Ljubljana, where 288,000 people live out of Slovenia's population of 2.1 million.

Conclusion

"The art of being wise is knowing what to overlook"
William James, Principles of Psychology (1890) vol. 2, ch. 22, p.18

These three countries in Eastern Europe are far from perfect, but they have well-educated populations motivated by what they see in Western Europe and striving to make convergence a reality in the coming years. One must overlook corruption and rapacious tax authorities in some places, but these countries proved rewarding for analysis – and in many cases, for investments as well.



An evening view of Tbilisi from Narikala Castle looking down on the old town and the Kura River. What looks like the moon is a tethered balloon for tourists to enjoy a brief but romantic voyage. Gathered on the bridge is a group with lights singing "Mravaljamieri," which means "live long", <https://www.youtube.com/watch?v=QI5yTbOBjx0> .

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ⁱ "Georgia" in Georgian means "warm place", from its numerous hot springs

ⁱⁱ Barbarestan Restaurant,

<https://www.theworlds50best.com/discovery/Establishments/Georgia/Tbilisi/Barbarestan.html>