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RESEARCH

Georgia's Wine & Spirits Sector

In Vino Veritas



Georgia | Wine & Spirits
Industry Overview | July 30, 2019

Eva Bochorishvili
Head of Research | evabochorishvili@gt.ge | +995 32 2401 111 ext. 8036

Bachana Shengelia
Head of Sector Research | bshengelia@gt.ge | +995 32 2401 111 ext. 7562

Mariam Chakhvashvili
Senior Analyst | mchakhvashvili@gt.ge | +995 32 2401 111 ext. 7897

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Executive summary

Georgia is considered the “cradle of wine” with a rich, 8,000-year history of wine-making and home to over 500 unique grape varieties. Having interrelated production processes, several large wine-making companies also produce brandy. While the history of Georgian brandy only begins in the 19th century, Georgia is already 10th-largest exporter of brandy globally. In 2018, 245,000 tons of grape were processed by over 300 winemaking companies, quite large production for a country with a small domestic consumption base. So it's not surprising that some 85% of the wine & spirits sector's revenue stream comes from exports, making it highly dependent on external markets.

Wine & spirits business is one of the most profitable sectors in Georgia. In 2017, the sector's net profit margin stood at 26.0% far above 8.4% recorded for the total business sector. The sector's revenue almost doubled over 2013-18 reaching GEL 867.9mn, with external demand being the main driver of revenue growth, as domestic sales stagnated. Wine is Georgia's 4th-largest export product and brandy is the 8th-largest with 5.9% and 3.2% of total, respectively. Wine and brandy exports from Georgia increased at a CAGR of 6.0% to US\$ 305.3mn over 2013-18, or 65mn liters of wine and 32mn liters of brandy exported in 2018. We expect 2019 to be another record-breaking year for the sector, with revenues set to increase up to 10% y/y thanks to an unprecedented grape harvest in 2018 and expected export growth.

2006 Russian embargo improved the quality of Georgian wine and diversified destination markets. Russia was almost sole consumer of Georgian wine before 2006 absorbing 92% of total wine exports. The embargo forced producers to improve wine quality and direct their exports to EU, Asian and other markets. As a result Georgia is exporting wine to 53 different countries now.

Reorientation from Russian market is high on agenda again. Re-opening of Russian market in 2013 quickly made it largest single market again absorbing c.60% of Georgia's total wine exports in 2018. This is the result of brand awareness and reactivation of old trading networks. While the topic of a possible Russian trade embargo is closed for now, it disturbed winemakers and needs for further diversification dominated recent headlines. Low price per exported liter in Russia is another argument to intensify efforts to reorient from Russian market. On a positive note, number of wineries rejected relatively easy money in Russian market since 2013 and invested heavily in expanding in non-traditional markets.

Wine and spirits exports to non-traditional markets tripled in dollar terms over 2013-18 which seems a good achievement considering bottlenecks in brand promotion and positioning. The availability of various grants and subsidized loans from government in recent years considerably increased number of small-scale wineries, with little capability to invest in brand development and distribution networks. Given continued growth in wine consumption in Asian markets, enhanced efforts in brand recognition and distribution networks can generate US\$ 120mn in exports in next 5-years, surpassing what Russia absorbs currently.

Wine & spirits sector lacks unified strategy. We interviewed a number of market players with an aim to identify major bottlenecks for export diversification. Absence of an industry collaboration platform or agreement regarding long-term positioning in export markets, weak corporate governance, and little progress in cluster-building were identified as key difficulties by sector players amongst others. Technologically unsophisticated production methods, high production cost of grape, the low yields, a lack of consistency in price and quality and fragmented processing base are other factors dragging consolidation and economies of scale in the industry.



1. Status quo and expectations

Before jumping into number crunching to analyze rising dependence on Russian market and sector growth potential it seems appropriate to understand perception of key market players. With this aim, we interviewed a number of players in the Georgian wine & spirits sector and key findings are listed below.

2006 Russian embargo on Georgian wine had positive effect on sector over long term. Georgia's wine sector was not very developed before 2006 in terms of quality control and corporate governance. The years that followed the embargo were difficult for the wine sector but companies invested heavily to diversify their export markets and to meet all of the quality or non-quality requirements in the EU, Asian and US markets.

Why is the sector's dependence on Russia still significant? Russian consumers are highly aware of Georgian wines and spirits and are loyal customers. Georgian producers also have logistical proximity to Russia and established business relationships with their Russian counterparts. Georgian companies are trying to export to new markets, but struggling to reduce their exposure to Russia.

If Russian embargo takes place again, redirecting products to alternative markets will not be easy, but achievable. The Georgian Wine Agency is investing heavily on wine marketing in different export markets, but more efforts will be needed if Russia enforces another embargo on the sector. Building up a loyal customer base in new markets is a long-term process, thus the EU, China and other markets will not replace Russia in one year.

Main headwinds to exporting to new markets are low awareness and high competition. Georgia's wine & spirits producers see no technical issues regarding exporting to European and Asian markets as Georgia has free-trade agreements with most of its target export countries and Georgian wine already meets various quality requirements. However, customers in those markets know very little about Georgian wine-making and its distinction from other wines. Furthermore, those markets are already fairly saturated by the well-established wine-makers like France and Spain.

Wine & spirits sector lacks unified strategy. Companies in Georgia's wine & spirits sector do not have a collaboration platform or agreement regarding their long-term positioning in their export markets. Corporate governance within the sector is still evolving but cluster-building and greater coordination are needed over the coming years. Large companies may also need to have their own vineyards to meet growing demand in export markets, with an aim to increase grape yield per ha and limit negative impact from varying grape prices.

Georgian wine more competitive in terms of quality than quantity. Georgian production capacity is limited; Even if grape producers fully utilize the total available area of vineyards, Georgia still cannot make enough wine to compete with Chile and Spain by quantity – main producers of cheap wine. Despite this fact, many companies in the sector think that Georgia should continue to focus on affordable wines, while maintaining better quality than low priced competitors. Some companies see opportunity to position in premium segment, with potential in unique varieties of wines produced in Georgia.



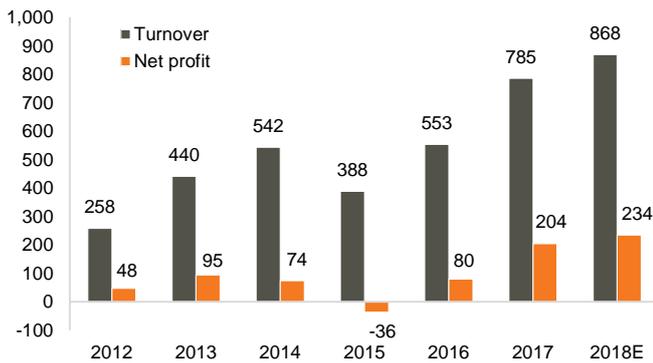
2. Wine & spirits business performance

Wine & spirits business is one of the most profitable sectors in Georgia. The sector's revenue increased c.2x over 2013-18. In 2017, the sector posted GEL 204.1mn net profit – or a 26.0% net profit margin – while this figure for the total business sector stood at 8.4%. Estimated revenue of wine & spirits sector reached GEL 867.9mn in 2018, up 10.6% y/y and net profit reached approximately GEL 230mn, thanks to growing exports and improved grape harvest.

The sector employs over 7,500 persons with 380 companies operating in the market. Some 90% of these companies are small¹. High profits and the availability of various grants and subsidized loans from government in recent years were the major reasons for large number of small-scale wineries in the sector.

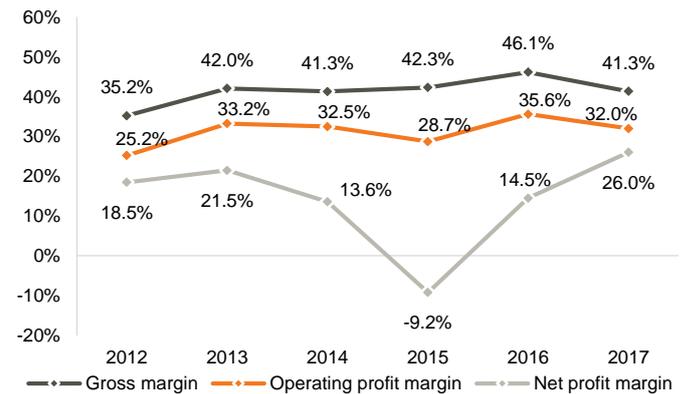
Some 85% of the wine & spirits sector's revenue stream comes from export markets. Meanwhile, large portion of local demand is still met by Georgian households' own production - Georgians take pride in giving their guests their own wine. This tradition is here to stay but growing urbanization and tourism inflows are raising demand for bottled wine locally.

Figure 1: Wine and spirits sector turnover, GEL mn



Source: Galt & Taggart Research, Geostat

Figure 2: Wine and spirits sector profitability



Source: Galt & Taggart Research, Geostat

Export dependence makes the sector very sensitive to the conditions in export markets. As such, currency weakness and poor economic performance in Georgia's major export partners in 2015 saw turnover in the Georgian alcohol sector fall 28.5% y/y, before rebounding in 2017 once the markets stabilized.

2006 Russian embargo improved the quality of Georgian wine and diversified destination markets. Russia was almost sole consumer of Georgian wine before 2006, and now Georgian wine is popular in EU, China, US and other markets. Dependence on Russian market started to increase since 2013 as trade relations were restored. A ban on Georgian wine has actively been discussed recently in Russia. However, the topic of wine sanctions against Georgia is closed for now after the President of the Russian Federation, Vladimir Putin, called for restraint and spoke in favor of a balanced approach. Currently, Russia consumes c.60% of wine exported from Georgia (US\$ 114.8mn in 2018). If Russian embargo takes place again, this will adversely affect sector in short term, but enhanced efforts in positioning in other markets may put the sector on growth curve again.

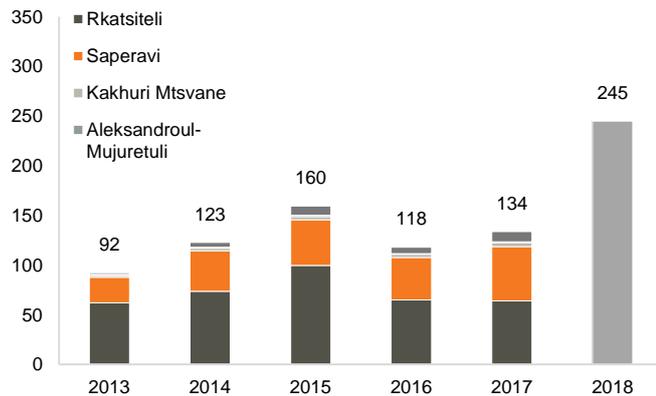
¹ According to Geostat classification, small companies have annual revenue below GEL 12mn and up to 50 employees.



Grape harvest skyrocketed to 245mn tons in 2018, while grape producers received GEL 313mn in revenue (up 66.3% y/y). The grape harvest in 2018 was the highest in this century on the back of favorable climate conditions.

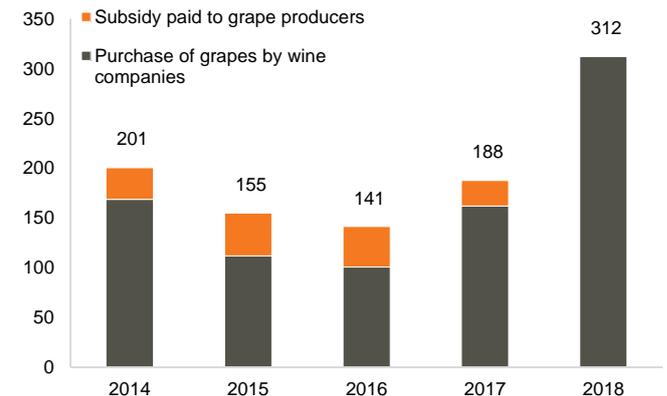
The state subsidy for grapes was abolished completely in 2018 given strong demand on Georgian wine from export markets. State subsidies paid to grape producers decreased from GEL 42.9mn in 2015 to GEL 25.7mn in 2017 before ending in 2018. Despite this, the market price of grapes was up in 2018 as demand was high from wine producing companies. Apart from subsidizing grapes, government has been supporting the sector through grants and subsidized loans in recent years.

Figure 4: Grape harvest by variety, mn tons



Source: National Wine Agency
Note: Breakdown of 2018 grape varieties not yet available

Figure 5: Revenue of grape producers per harvest, GEL mn

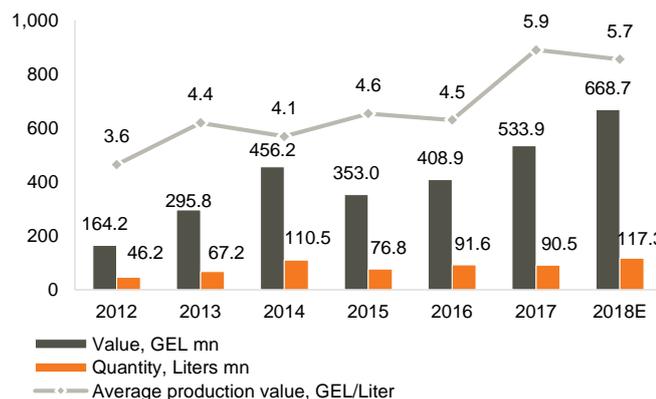


Source: National Wine Agency, G&T Research

Most of the grapes produced in Georgia are used for wine production. About 15-20% of the grapes that are harvested are consumed by individuals for winemaking, while the rest is sold to wine-producing companies. The consumption of table grapes on average only totals 11mn kg/year – a mere 6% of total grape production. The industry is characterized by having quite a high amount of work-in-process inventory at year-end as the grapes used for wine and brandy production only become their intended end-products after several months or years of aging.

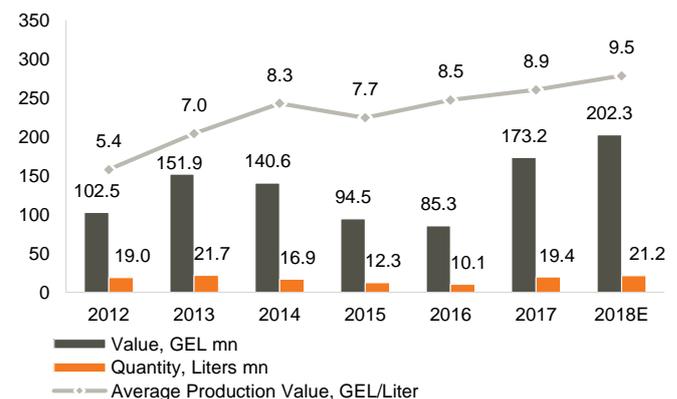
Industrial production of wine and spirits almost doubled over 2013-18 and reached GEL 870.9mn in 2018, supporting the sector revenue growth. Some 117mn liters of wine and c.20mn liters of brandy were produced in 2018, with total production values of GEL 668.7mn and GEL 202.3mn, respectively. The main driver for the increased production has been anticipated higher demand in export markets. The availability of grapes also impacts overall production trends. Notably, wine production increased most with a CAGR of 17.7% in liters over 2013-18, while spirits production grew at a 5.9% CAGR over the same period.

Figure 6: Production of wine in Georgia by business sector



Source: Geostat, G&T Research

Figure 7: Production of spirits in Georgia by business sector



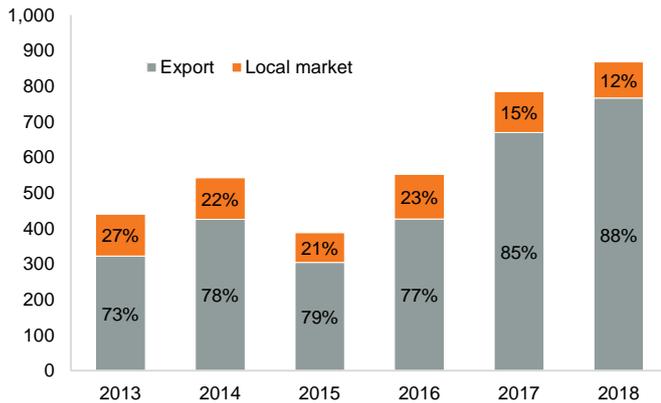
Source: Geostat, G&T Research



4. Demand for wine and brandy

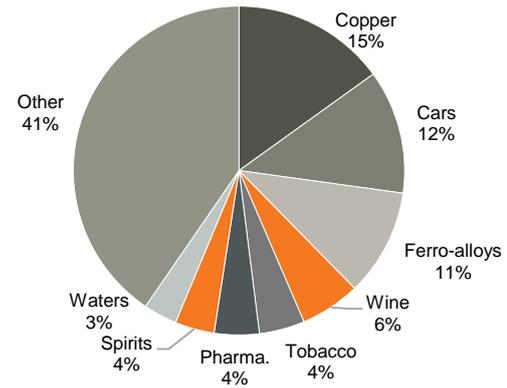
Exports are the main driver of sector revenue growth. Revenue from wine and spirits exports grew rapidly at 18.9% CAGR over 2013-18, reaching GEL 766mn (c.US\$ 300mn) in 2018. Meanwhile, local sales stagnated. Therefore, the doubled revenue of the sector is fully attributable to exports.

Figure 8: Wine and spirits sector turnover, GEL mn



Source: Geostat, G&T Research

Figure 9: Georgia's exports by products, 2018



Source: Geostat

Note: Brandy is included in spirits category, holding 83% share in total this category

4.1 Local demand

Local sales reflect consumer behavior and economic conditions. The annual per capita consumption of wine has decreased from 28 liters in 2013 to 19 liters² in 2018. There was temporary pick-up in local sales in 2016, before dropping again in 2017-18. One reason behind this drop was likely related to growth in wine prices. Another explanation may be local consumers shifting towards more expensive bottled wines and brandies instead of drinking large volumes of cheap un-bottled wines. The appearance of different youth-oriented brands and upper-end wine restaurants have also affected consumer behavior, increasing interest in premium wines. Official statistics not available for home-made wine production, but our calculations from various sources indicate a decrease in this category due to the affordability of wine in retail chains. Importantly, growing number of tourists and related increase in expenditures on food and beverages were not sufficient to compensate reduced consumption by locals.

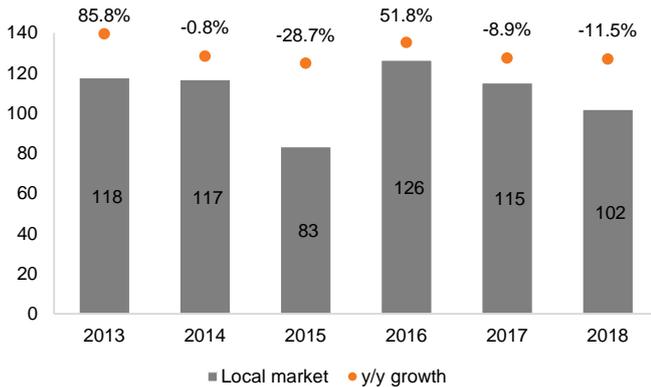
Revenue of wine and brandy business sector from local sales totaled about GEL 100mn in 2018, down from GEL 117.5mn in 2013. Our estimation of local market size including home-made wine is c.60mn liters in 2018. In 2017, brandy prices increased due to higher excises on spirits (from GEL 9.2 per liter up to GEL 15 per liter of pure alcohol), while wine prices rose due to increased production costs (see figure 11).

² The per capita consumption of wine is defined as the total (sum of recorded and unrecorded) amount of wine consumed per person (15+ years-old population) over a calendar year in liters including tourist consumption. Per capita consumption of wine is calculated based on Geostat food balance of grapes (including wine consumption).



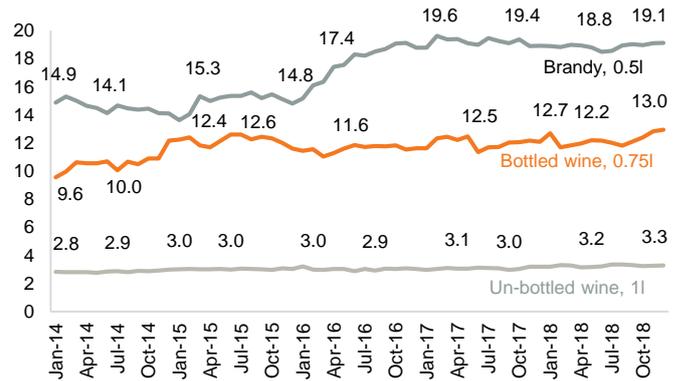
Local market has room for growth. Although Georgia has a history of wine-making and wine-drinking, per capita (15+ years) wine consumption at 19 liters/year is significantly lower than the main wine-making countries such as Portugal (58.8 liters/year), France (50.7 liters/year), Italy (44 liters/year) and Spain (26.4 liters/year). This, together with the prospect of strong growth in wine tourism, create room for healthy growth in demand for Georgian wine.

Figure 10: Revenue from local wine and brandy market, GEL mn



Source: Geostat, G&T Research

Figure 11: Average retail prices, GEL per bottle



Source: Geostat

4.2 Wine and brandy exports

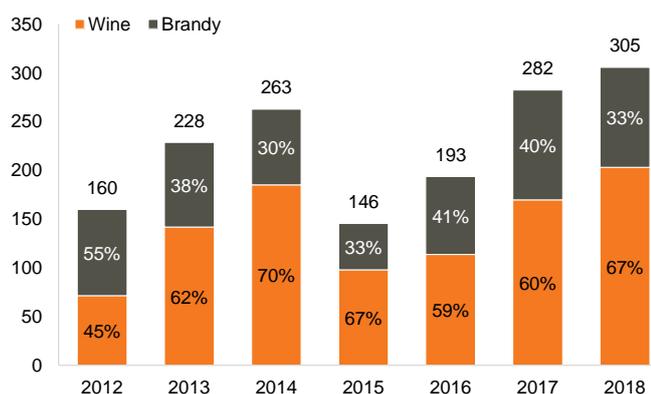
Wine is Georgia's 4th-largest export product and brandy is the 8th-largest. Wine and brandy exports stood at 97mn liters or US\$ 305.3mn in 2018, of which 45.0% was directed to Russia, 17.7% to Ukraine and the rest went to other non-traditional markets.

The dependence on Russian market and other post-soviet countries is quite significant, but demand from non-traditional markets (the EU, China and other countries) has increased 3.0x over 2013-18.

Wine exports increased most in 2013-18 while brandy exports was relatively flat over years. Notably, in 2015-16 wine exports fell sharply due to economic problems in major export markets (mostly Russia and Ukraine), while brandy exports dropped only in 2015 and surpassed pre-crisis level in 2016 already.

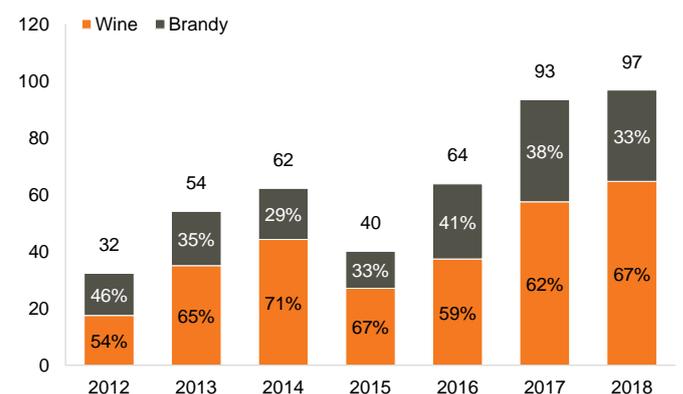
Re-opening of Russian market in 2013 mostly boosted sales of wine, doubling the exports of wine both in terms of value and volume. Wine exports rose from 35mn liters to 65mn liters over 2013-18, while brandy exports expanded from 19mn liters to 32mn liters over the same period.

Figure 12: Wine and brandy exports from Georgia, US\$ mn



Source: National Wine Agency

Figure 13: Wine and brandy exports from Georgia, Liters



Source: National Wine Agency



Brandy exports

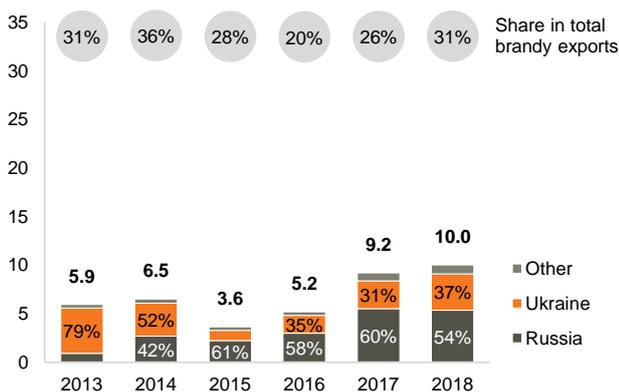
Georgia is 10th-largest exporter of brandy globally, being top brandy source market for Ukraine, Armenia, France and Spain. Georgian brandy is exported to 37 countries. Georgia accounted for 82.6% of brandy imports in Armenia, 43.6% in Ukraine, 22.6% in Spain and 20.2% in France in 2018. Top brandy export companies are Bolero & Company, Kakhetian Traditional Winemaking, Askaneli Brothers, Sarajishvili and Caucasian Alco, based on official statistics. Georgian companies also produce other types of spirits (chacha, etc), but their share in total spirits production is low.

Brandy exports increased at a 9.3% CAGR over 2013-18 to c.US\$ 102mn in 2018. Alongside bottled brandy, the brandy spirits (intermediate product in brandy production) are another highly popular exports. In fact, 59% of exported brandy in 2018 was in the form of brandy spirits. This was mainly exported to Ukraine, France, Spain and other top brandy producers, making Georgia one of the top source markets for these countries.

On average, bottled brandy is 1.5x more expensive than brandy spirits. The average export price for Georgian brandy has been falling over 2013-18, both for bottled brandy and brandy spirits, due to the decrease in ethyl alcohol prices globally. In 2018, the average price of bottled brandy was US\$ 4.1 per liter (down from US\$ 6.0 in 2013), while the average price of brandy spirits was US\$ 2.8 per liter (down from US\$ 3.9 in 2013).

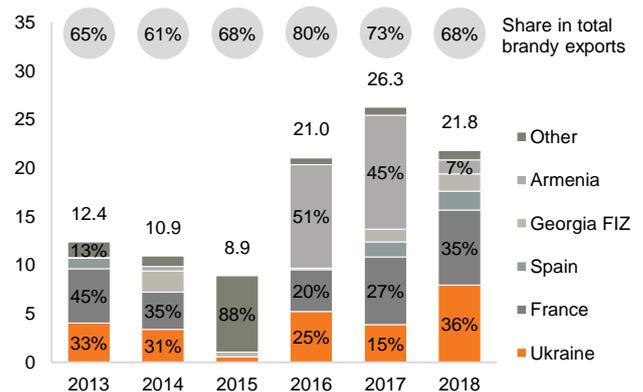
Russia and Ukraine are main export markets for bottled brandy, while France and Spain have the highest demand for brandy spirits. In 2018, 20mn bottles of brandy were exported, of which 54% went to Russia and 37% to Ukraine. Ukraine was also the top export market for brandy spirits in 2018. France, Spain and Armenia are the other top markets for Georgian brandy spirits, with their shares varying annually in total exports in line with local production dynamics.

Figure 14: Bottled brandy exports, mn liters



Source: National Wine Agency

Figure 15: Brandy spirits exports, mn liters



Source: National Wine Agency

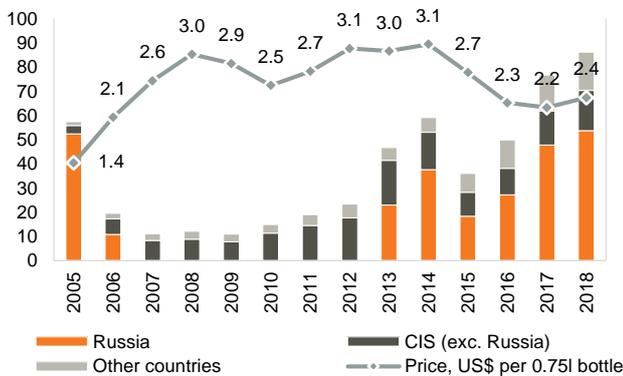


Wine exports

Wine is Georgia's 4th-largest export product after copper, cars and ferro-alloys. According to the National Wine Agency, wine exports totalled US\$ 203.1mn or 86.2mn bottles in 2018 (up 19.7% y/y and 12.4% y/y, respectively).

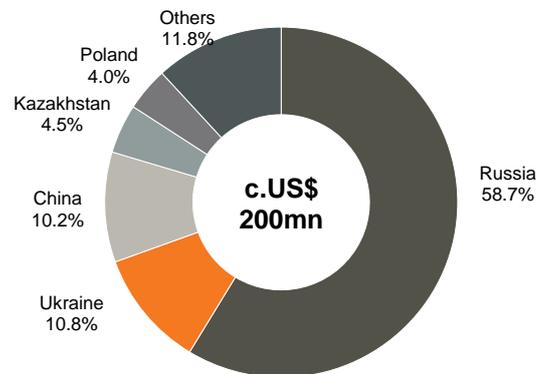
Georgia is exporting wine to 53 different countries. The free trade agreements with EU and China (major wine consuming countries) give opportunity for market diversification and the further export growth. Russia remains largest consumer of Georgian wine despite the significant decrease in its share in overall wine exports from 91.2% in 2005 to 58.7% in 2018.

Figure 16: Georgian wine exports, mn bottles



Source: National Wine Agency

Figure 17: Wine exports, 2018



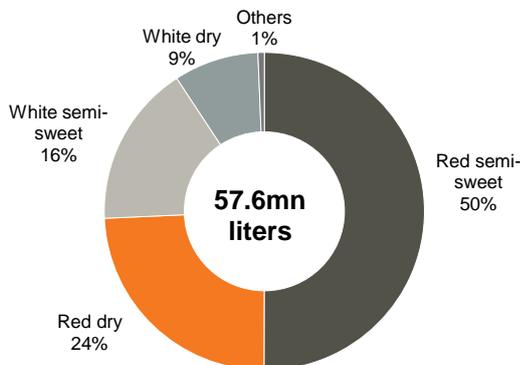
Source: Ministry of Finance

Growth continued in 2019 – Georgia exported 40.4mn bottles of wine in 1H19 – a 5.9% y/y increase in volume terms and a 8.7% y/y increase in value terms.

Georgian wine is mainly positioned as midscale wine on major export markets. Georgian wine export price is 13% lower in CIS countries than in EU or China. In general, average price of Georgian wine exports follows the global wine price trends.

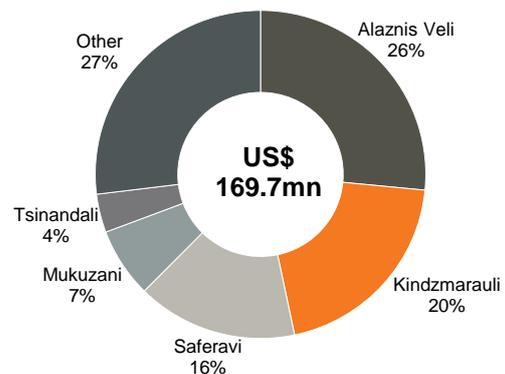
Red semi-sweet and red dry wines were the most popular export categories, driven by customer preferences in the CIS markets. Saperavi, Kindzmarauli and Mukuzani are the most popular and the most expensive wines for export in this category. Georgia's top wine in terms of export value in 2017 was Alaznis Veli at an average price of US\$ 2.6 per liter, accounting for 26.5% of revenue.

Figure 18: Georgian wine exports by category, 2017



Source: National Wine Agency

Figure 19: Georgian wine exports by product, 2017



Source: National Wine Agency



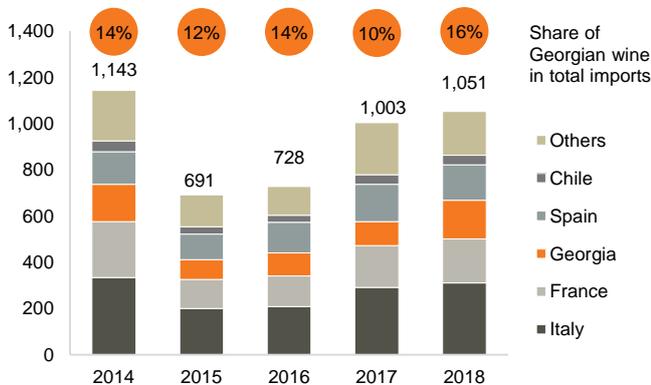
Exports to Russia

Russia remains top wine export market despite diversification since 2006 Russian embargo. 58.7% of Georgia’s total wine exports was directed to Russia in 2018. Some US\$ 115mn was generated from the Russian market last year. Before 2006, Georgia was highly dependent on Russia absorbing c.90% of the country’s wine exports. Russian ban on Georgian wines in 2006 reduced total wine exports by 64.3% over 2005-07.

Georgia is Russia’s 3rd largest source country for wine imports after Italy and France. Russia was 9th-largest wine consumer globally in 2017, consuming c.900mn liters of wine and 110mn liters of brandy. Some 55% of total demand in 2018 was satisfied by domestic production. The remainder was imported from over 20 countries. Georgian wine accounted for c.15% of total imported wine in dollar terms in 2018 and satisfied approximately 6.5% of local demand. Georgian wine is well positioned on the Russian market with a price slightly above the average import price: 1.5x higher than main competitor, Spain; and 2.0x and 1.5x lower than premium French and Italian wines, respectively. Due to this price difference, lower-price Spanish wines are 4th-largest after Georgia with 14.7% share in dollar terms, but Spain is 2nd-largest wine importer in volume terms with 21.2% of total imported wines to Russia.

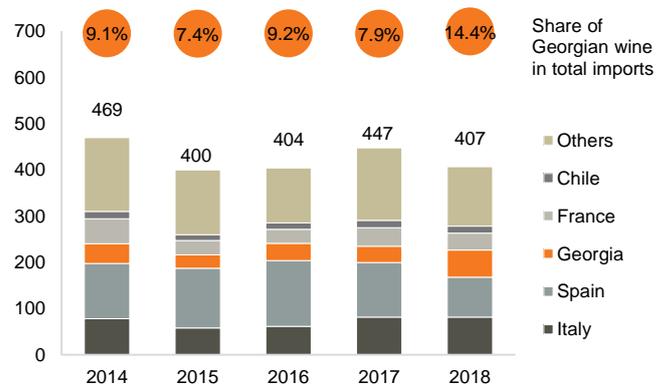
Wine consumption decreased significantly as a result of the economic problems in Russia in 2014-15. However, it is expected to grow slightly over the next five years based on recent studies after falling by an average 5% annually over 2012-17.

Figure 20: Wine imports to Russia, mn US\$



Source: Trademap

Figure 21: Wine imports to Russia, mn liters



Source: Trademap

Exports to Ukraine

Ukraine is Georgia’s 2nd-largest market for exported wine, grossing US\$ 21.1mn 2018. Ukraine imported 37.8mn liters wine in 2018, of which Georgian wine accounted for 19.4%, only behind Italian wine. Wine consumption in Ukraine has been stable in recent years after falling sharply in 2014 due to the Russian military intervention in the country. The share of imported wine in overall Ukraine wine demand increased slightly from 24% in 2014 to 27% in 2017-18. The government plans to support local production, which will increase the competitiveness of local wines.



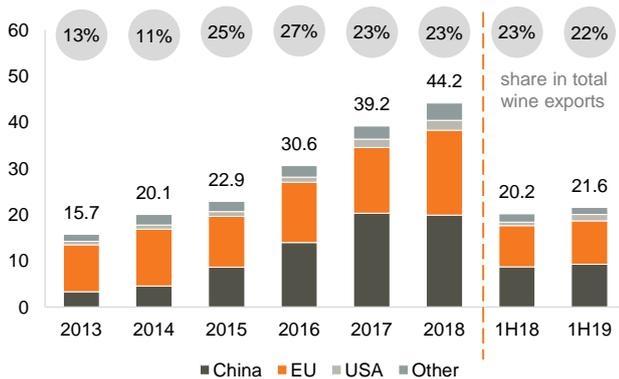
Exports to China

Exports to China increased 6x over 2013-18. China is set to surpass Ukraine and become Georgia's 2nd-largest export market in 2019, showing 19% y/y growth in 1H19. China is the 5th-largest market globally in terms of wine consumption and imported some US\$ 2.8bn of wine in 2018. Georgia accounted for just 0.7% of total wine imports to China in 2018, which is set to increase on the back of the rising popularity of Georgian wine there. Given continued growth in wine consumption in Asian markets, enhanced efforts in brand recognition and distribution networks can generate US\$ 120mn in exports in next 5-years, surpassing what Russia absorbs now.

Exports to EU

EU is next promising market for Georgian wine exports, with 12.5% CAGR over 2013-18, reaching US\$ 18.4mn in 2018. As of 2018, Poland, Latvia and Germany are the top three EU recipients of Georgian wine. The increasing popularity of Georgian wine in the bloc – in line with the joint efforts by the state and by Georgian businesses towards closer relationships with Europe – gives us confidence that the EU market presents as yet untapped potential.

Figure 22: Georgia's emerging export markets for wine, US\$ mn



Source: Ministry of Finance



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Head of Research

Eva Bochorishvili | evabochorishvili@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia

Tel: + (995) 32 2401 111

Email: research@gt.ge

Head of Macroeconomic Analysis and Forecasting

Lasha Kavtaradze | lashakavtaradze@gt.ge

Head of Analytics

Giorgi Iremashvili | giremashvili@gt.ge

Head of Sector Research

Bachana Shengelia | bshengelia@gt.ge

Senior Analyst

Mariam Chakhvashvili | mchakhvashvili@gt.ge

Senior Analyst

Kakha Samkurashvili | ksamkurashvili@gt.ge

Senior Analyst

Ana Nachkebia | anachkebia@gt.ge

Analyst

Tatia Mamrikishvili | tmamrikishvili@gt.ge

Analyst

Nino Peranidze | ninoperanidze@gt.ge

Analyst

Nika Megutnishvili | nmegutnishvili@gt.ge