JSC Nikora
Georgia, Consumer Products and Retail

SCOPE **BB-** Negative

Corporate Profile

JSC Nikora (Nikora) is the parent company of Nikora Trade. While the latter is only active in the retail sector, holding company Nikora includes additional entities focused on importing, producing and distributing food. Around 30% of Nikora Trade's purchases are made from integrated suppliers belonging to Nikora. The group currently has more than 7,000 employees and is solely focused on Georgia.

Key metrics

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	3.3x	2.6x	2.9x	3.2x	3.5x
Scope-adjusted debt (SaD)/EBITDA	4.0x	4.5x	3.3x	3.0x	2.8x
Scope-adjusted funds from operations/SaD	17%	13%	19%	22%	25%
Free operating cash flow/SaD	-13%	-6%	-6%	-4%	2%

Rating rationale

Scope Ratings GmbH (Scope) has today affirmed its BB- issuer rating on Nikora and revised the Outlook to Negative from Stable. Scope has also affirmed its BB- rating for the senior unsecured debt category.

The Outlook change reflects Nikora's weakened financial profile driven by lower-than-expected operating performance in 2020. Significantly elevated leverage and inadequate liquidity could shake the issuer rating as both downward rating triggers have been breached based on 2020 results. However, the group's H1 2021 results, confirmed by management, promise recovery.

Group profitability remained in comfortable territory thanks to the flat profitability of Nikora Trade. Overall group margins decreased slightly to 9.1% due to local currency devaluation. This is because most cash flows are generated in local currency, while substantial raw material costs are imported without any foreign exchange hedging activities - a common characteristic of the Georgian retail market.

There has been a deterioration in both Nikora's leverage metrics: Scope-adjusted debt (SaD)/EBITDA peaked at 4.5x at YE 2020 versus 4.0x at YE 2019 and funds from operations (FFO)/SaD dropped to 13% versus 17% the year before. This was due to the debt-financed buyback of preference shares in the amount of GEL 18.0m, the fluctuation of foreign exchange rates elevating indebtedness by GEL 13.1m, and a GEL 15.0m deficit in projected EBITDA (absolute terms).

The current debt structure significantly weakens Nikora's liquidity profile. Low cash levels of around GEL 5.0m available at YE 2020 appear insufficient to fully cover (re)-financing needs from expected negative free operating cash flow in 2021-2022 of around GEL 10m and a short-term working capital loan of around GEL 30m. Even if accounting for the group's undrawn committed lines of GEL 13.2m, the ratio remains inadequate, exposing Nikora to continued refinancing risks and a strong dependency on its banks. Hence, liquidity weighs negatively on Nikora's overall rating.

We note that the flow of information between management and Scope remained very slow.

Ratings & Outlook

Corporate rating	BB-/Negative
Senior unsecured rating	BB-

Analyst

Zurab Zedelashvili
+49 69 667738 947
z.zedelashvili@scoperatings.com

Related Methodology

Corporate Rating Methodology: July 2021

Rating Methodology: Retail and Wholesale Corporates March 2021

Rating Methodology: Consumer Products, September 2020

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. + 49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Outlook and rating-change drivers

Stable Outlook

The Outlook is Negative and reflects the risk of leverage remaining at elevated levels: SaD/Scope-adjusted EBITDA staying above 4x and FFO/SaD below 15%. It also incorporates the fact that Nikora will continue operating with very limited liquidity due to a heavy investment phase and lease repayments limiting free operating cash flow generation.

Rating upside

A positive rating action (i.e. an Outlook change to Stable from Negative) could be the consequence of SaD/Scope-adjusted EBITDA below 4x and FFO/SaD above 15% on a sustainable basis. This could be achieved if, for instance, the top line grows more strongly, outpacing the forecasted surge in raw materials prices, or the level of inventory shrinkages is decreased.

Rating downside

A negative rating action could result from a deterioration in credit metrics, as indicated by FFO/SaD falling below 15%, SaD/ EBITDA increasing above 4x on a sustained basis or if there is no significant improvement in the transparency and consistency of information provided by the group.

Rating drivers

Positive rating drivers	Negative rating drivers
• Owner of Nikora Trade, which holds a high share of Georgia's retail market and has high profitability for a retailer • Integrated consumer goods business model with Nikora Trade • Although small in terms of size for the group, Nikora FMCG (fast moving consumer goods) is one of the largest organised food producers in the country • High EBITDA cash conversion benefiting from bargaining power on local market • Modest leverage constrained by USD foreign exchange risk	• Cash flow cover remains under pressure due to significant capex spending and lease repayments • Limited diversification of the group outside of Georgia • Inadequate liquidity • Weak transparency (negative ESG rating driver)

Rating-change drivers

Positive rating drivers	Negative rating drivers
• SaD/Scope-adjusted EBITDA below 4x and Scope-adjusted FFO/SaD above 15% on a sustained basis • Improvement in liquidity • Increase in the critical size of the group	• SaD/Scope-adjusted EBITDA above 4x on sustained basis • Scope-adjusted FFO/SaD below 15% on sustained basis • Lack of transparency

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	3.3x	2.6x	2.9x	3.2x	3.5x
SaD/EBITDA	4.0x	4.5x	3.3x	3.0x	2.8x
Scope-adjusted FFO/SaD	17%	13%	19%	22%	25%
FOCF/SaD	-13%	-6%	-6%	-4%	2%
Scope-adjusted EBITDA in GEL '000	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	51,814	54,918	70,873	74,587	76,229
Operating lease payments in respective year	0	0	0	0	0
Other	0	0	0	0	0
Scope-adjusted EBITDA	**51,814**	**54,918**	**70,873**	**74,587**	**76,229**
Scope-adjusted funds from operations in GEL '000	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	51,814	54,918	70,873	74,587	76,229
(Net) cash interest as per cash flow statement	-15,750	-20,888	-24,722	-23,006	-22,017
Cash tax paid as per cash flow statement	-725	-993	-618	-618	-618
Other	0	0	0	0	0
Scope-adjusted FFO	**35,339**	**33,037**	**45,533**	**50,964**	**53,595**
Scope-adjusted debt in GEL '000	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	206,881	249,826	235,429	226,872	215,961
Cash, cash equivalents	0	0	0	0	0
Guarantees	0	0	0	0	0
Provisions	0	0	0	0	0
SaD	**206,881**	**249,826**	**235,429**	**226,872**	**215,961**

Business risk profile: BB-

Credit-supportive industry risk

Nikora's industry risk profile (assessed at BBB+) benefits from a blended industry risk of non-cyclical retail (BBB) and non-durable consumer products (A), which has low cyclicality, low-to-medium barriers to entry and low substitution risk.

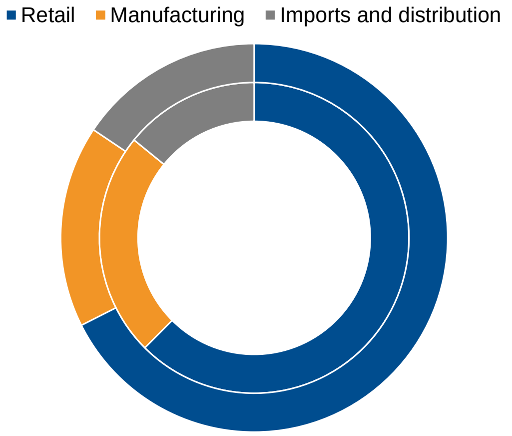
Dominant player on Georgian consumer product and retail landscape

Nikora's competitive positioning continues to benefit from its position as a key national player in the consumer goods and retail industries, including producing entities with high national brand recognition. While the retail sector remained resilient to the Covid-19 pandemic, Nikora's FMCG production arm was negatively affected due to its exposure to HoReCa[1] sales.

Limited size

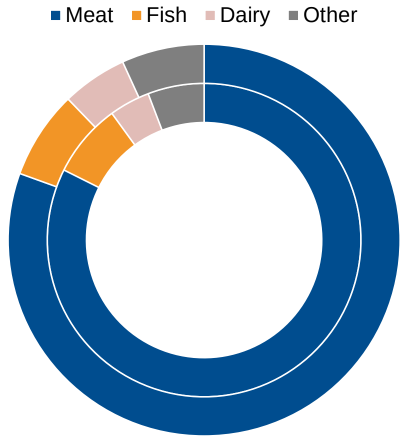
Following the introduction of our dedicated sectorial methodologies (Retail and Wholesale Corporates and Consumer Products), we assess the group's market shares as constrained by its size (GEL 603m in revenues for FY 2020). Although Nikora Trade's size is significant in Georgia, this is one of the most negative rating drivers of the group's business risk profile.

Figure 1: Group unconsolidated operations (2020)



Source: Nikora, Scope

Figure 2: Nikora FMCG – product split by category (inner circle Dec 2019, outer circle Dec 2020)



Source: Nikora, Scope

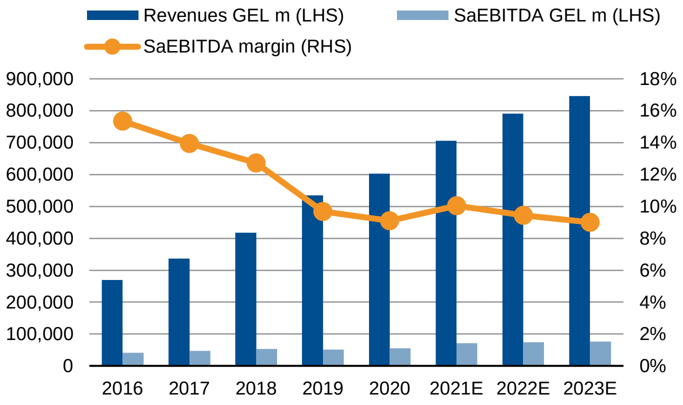
Diversification remains weakest component of business risk profile

Diversification benefits from a vertically integrated group structure. Geographical diversification remains the weak element of the group's business risk profile. Coverage of the full value chain from the import of raw materials, food processing and packaging through to B2C and B2B sales provides operational flexibility. The Nikora FMCG arm is mainly exposed to meat products (about 80% of total sales).

We expect the expansion of Nikora Trade to have a positive effect on the growth of the Nikora FMCG arm. However, dependence on Nikora Trade is high as around 60% of Nikora FMCG's sales are linked to intra group sales. We do not expect this to change in the medium term. The risk of significant sales exposure to Nikora Trade is partially mitigated by the ability of this company to deliver quality-oriented products and maintain sustainable business operations. We also believe overall group's new product portfolio and expansion strategy will help it to achieve double-digit consolidated revenue growth and protect cash flow generation in the next few years.

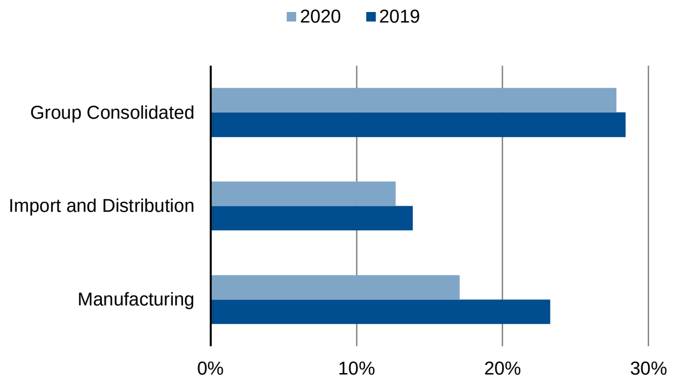
[1] Hotel, restaurant, cafe

Figure 3: Group's consolidated operating performance



Source: Nikora, Scope estimates

Figure 4: Group's gross margin overview



Source: Nikora, Scope

Profitability margins are relatively high compared to local sector median

Group profitability remained in comfortable territory thanks to the flat profitability of Nikora Trade. Overall group margins decreased slightly to 9.1% due to local currency devaluation. This is because most cash flows are generated in local currency, while a substantial amount of materials are imported without any foreign exchange hedging activities - a common characteristic of the Georgian retail market. The heavy dependence on imported materials may put Nikora Trade's gross margins profile under further pressure if the Georgian currency continues to devalue against the euro/US dollar in 2021-2023. We believe that Nikora's decreasing profitability trend will continue as market competition coupled with the group's expansion plans outside of Tbilisi area is likely to put pressure on profitability. This will, however, be partially mitigated by the potential for increased operating efficiency from scale effects or increased bargaining power.

Credit supportive brand strength

We view positively Nikora's brand strength. The company's 17 years of operations have created brand recognition and a loyal customer network, which is, however, limited to the region in which it operates. Outstanding local customer loyalty is driven by constantly strengthened product quality, the variety of Nikora's product portfolio and offerings tailored to consumers' needs.

Financial risk profile: B+

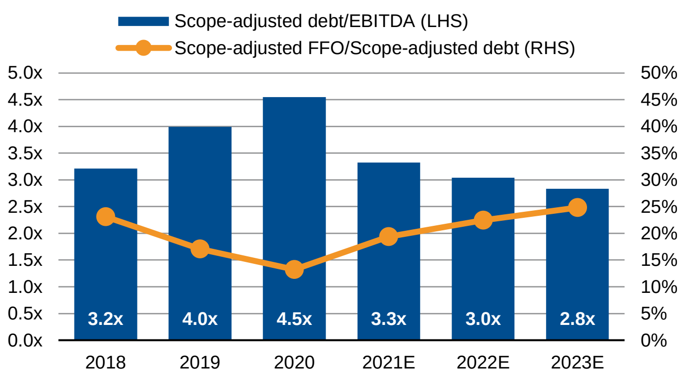
Adjustments and assumptions

Our adjustments include the following key elements:

- Available cash and cash equivalents are excluded from our SaD calculation
- Free operating cash flow has been adjusted by the amount of the repayment of leases and dividends on preference shares
- Scope-adjusted EBITDA does not include adjustments for the received government subsidy on personal income tax

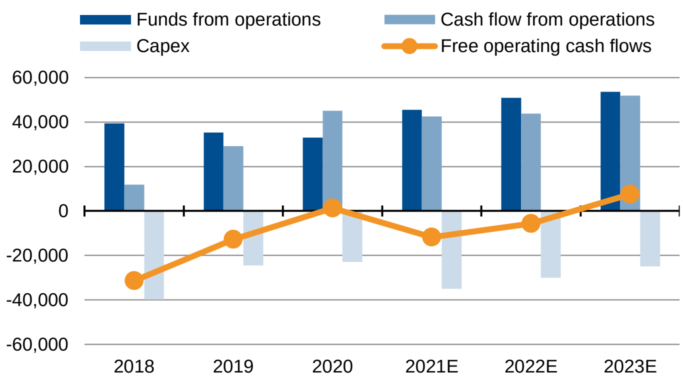
Nikora's financial risk profile is weaker than its business risk profile and is constrained by lower-than-expected operating performance in 2020. There has been a deterioration in both Nikora's leverage metrics: SaD/EBITDA peaked at 4.5x at YE 2020 versus 4.0x at YE 2019 and FFO/SaD dropped to 13% versus 17% the year before. This was due to the debt-financed buyback of preference shares in the amount of GEL 19.0m, the fluctuation of foreign exchange rates elevating indebtedness by GEL 13.1m, and a GEL 15.0m deficit in projected EBITDA (absolute terms).

Figure 5: Leverage



Source: Nikora, Scope estimates

Figure 6: Cash flow cover (GEL '000)



Source: Nikora, Scope estimates

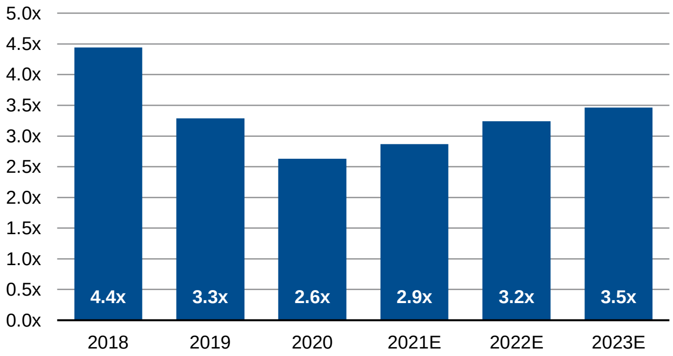
Similar to Nikora Trade, most of the group's leases are denominated in USD. Consequently, foreign exchange rates had a significant effect on the movement of lease liabilities in the amount of GEL 13.1m in 2020. This USD foreign exchange exposure makes the group's indebtedness volatile.

We anticipate stronger operating performance for the year 2021. We expect Nikora's FMCG arm to perform better after sales recovery to HoReCa and group's EBITDA to continue double digit growth in absolute terms (partially confirmed by H1 2021 results) additionally supported by ramping up of newly opened stores of Nikora Trade. The repayment of debt in the amount of GEL 15m together with the potential positive effect of foreign exchange gains would further support Nikora's leverage. We expect leverage below 3.5x going forward (2021E: 3.3x, 2022E: 3.0x).

The relatively high cost of debt in Georgia puts pressure on EBITDA interest coverage. Nikora's interest cover deteriorated further in 2020 due to higher-than-expected interest on leases. We expect the ratio to remain at a modest level of above 2.5x in 2021-2023, supported by the increasing absolute value of EBITDA while cost of debt remains at the current level.

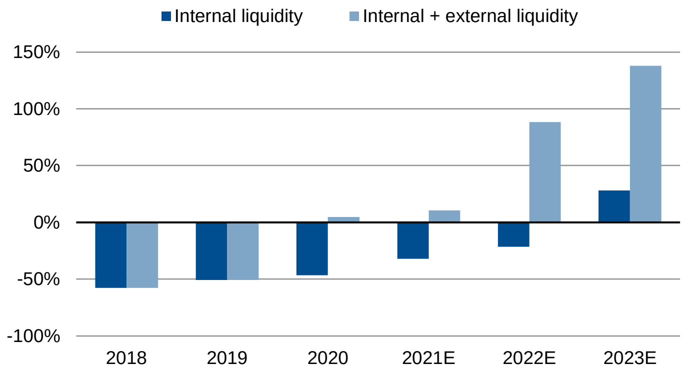
Continued investments in Nikora Trade's expansion strategy are likely to impact the group's overall free operating cash flow. Similar to Nikora Trade, cash flow cover is the weakest element of Nikora's financial risk profile. However, we view positively the group's financial flexibility in terms of capital spending. Annual capex is expected in the low double-digit million range (GEL 20-35m).

Figure 7: EBITDA interest cover



Source: Nikora, Scope estimates

Figure 8: Liquidity



Source: Nikora, Scope estimates

Inadequate liquidity profile

The current debt structure, amount of short-term debt, significantly weakens Nikora's liquidity profile. We estimate that low cash levels of around GEL 2.0-5.0m available on the balance sheet will be insufficient to fully cover (re)-financing needs from expected negative free operating cash flow in 2021-2022 of around GEL 10m and a short-term working capital loan of around GEL 30m. Even accounting for the group's undrawn committed lines of GEL 13.2m, the ratio remains inadequate, exposing Nikora to continued refinancing risks and a strong dependency on its banks. Hence, liquidity weighs negatively on Nikora's overall rating.

Position	2021E		2022E	
Unrestricted cash (t-1)	GEL	4.9m	GEL	2.3m
Open committed credit lines (t-1)	GEL	13.2m	GEL	13.2m
Free operating cash flow	GEL	-11.8m	GEL	-5.6m
Short-term debt (t-1)	GEL	31.1m	GEL	30.0m
Coverage		**0.1x**		**0.9x**

Supplementary rating drivers

Credit-neutral supplementary rating drivers

We have not made any explicit rating adjustment for supplementary rating drivers. However, we note that the flow of information between management and Scope remained slow. While this has not led to any rating impact so far, it may warrant a downgrade going forward (ESG rating driver).

Long-term debt rating

Senior unsecured debt affirmed at BB-

We affirm senior unsecured debt at BB-, reflecting our expectation of an average recovery for senior unsecured debt positions. Our recovery expectations are based on an estimated liquidation value in a hypothetical default scenario in 2023. In this scenario we assume that market conditions are tough and that the outstanding bank facility at the time is fully drawn.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44020-7340-6347

info@scoperatings.com
www.scoperatings.com

Disclaimer