Nikora JSC
Georgia, Retail / Consumer Goods

BB- STABLE

Corporate profile

Nikora JSC is the parent company of Nikora Trade. While the latter is only present in the retail sector, holding company Nikora JSC includes additional entities focused on importing, producing and distributing food. As integrated suppliers, around 23% of Nikora Trade's purchases are made from companies belonging to Nikora JSC. The group currently has 6,118 employees and is solely focused on Georgia.

Key metrics

			Scope estimates	
Scope credit ratios	2017	2018	2019f	2020F
EBITDA/interest cover (x)	4.0x	4.4x	4.5x	4.6x
Scope-adjusted debt (SaD)/EBITDA	3.1x	3.1x	2.9x	2.8x
Scope-adjusted FFO/SaD	23%	24%	26%	27%
FOCF/SaD	0%	-13%	-1%	11%

Rating rationale

The issuer rating mainly reflects Scope's perception of Nikora JSC as one of the key national players in the fast-moving consumer goods (FMCG) and retail industries. Scope views high interest cover as a support to the rating but considers low profitability, negative free operating cash flow (FOCF) and low liquidity as negative rating drivers.

The rating benefits from Nikora JSC's dominant market share within the country, bolstered by a considerable shop network (through its daughter company, Nikora Trade, rated B+) and by strong FMCG producing entities with high national brand recognition. In detail, Nikora Trade owns close to 20% of the modern retail market share in the country, spearheaded by a high number of shops across all regions and all formats, ensuring a stable revenue stream. This shop network reinforces the market share of the group's FMCG-producing companies, which sell to Nikora Trade (23% of sales). Our business risk profile analysis highlights the weight of the group's meat production arm, which is a clear market leader with close to 30% of the national market. Although the rest of the entities are smaller in terms of size, they manufacture a large range of edible products, thus contributing to overall product diversification.

The group's presence in two activities (FMCG and retail) supports its overall diversification. The fact that the group only offers edible products is not detrimental to the rating due to the high robustness of the food sub-industry. We consider Nikora JSC to be well positioned within this industry because its entities offer most edible products. Despite the weight of meat (66%), the group also offers dairy (3%), fish (6%) and other non-classifiable goods (25%). We assess customer diversification as high because Nikora Trade sells to every category of the Georgian population through different shop formats. Additionally, the producing entities not only sell to Nikora Trade but also to the vast majority of the country's retailers, ensuring a certain amount of customer flexibility and strong negotiating power. While the absence of e-commerce solutions could be viewed negatively, as it represents one of the key drivers of food retail going forward, we believe that the Georgian market is not yet sufficiently mature for e-commerce to play a role yet. The main weakness of Nikora JSC remains the lack of exports or a footprint beyond the borders of Georgia, ultimately making it dependent on macro conditions in the country.

Ratings & Outlook

Corporate ratings BB-/Stable

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Related methodology

Corporate Methodology 2019

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As regards profitability, Nikora JSC suffers from relatively low profitability (based on Scope-adjusted EBITDA) having reached around 12.5% in YE 2018, attributed at 66% to FMCG activities and 33% to retail (based on unconsolidated reported EBITDA). In detail, the overall profitability of FMCG is generated by the meat producing entities (Nikora LLC and Nikora 7) representing 33% of total reported EBITDA and averaging 11% – versus 4% for Nikora Trade based on the same figures. We consider the profitability of FMCG activities to be relatively low compared to peers. This reflects a strategic choice to trade some profitability for volume and to support Nikora Trade JSC.

We forecast that Nikora JCS will increase its level of indebtedness over 2019 and 2020 but will start to deleverage in 2021, in contrast to Nikora Trade which started to reduce its debt level this year. Nikora Trade's expected financial recovery should bolster the cash recorded on the balance sheet in 2020 by Nikora JSC, limiting the rise in net debt that the holding company is planning to issue. We also expect an increase in operating lease commitments, reflecting the rise in Nikora Trade's number of shops and the creation of new meat processing facilities for Nikora LLC. In terms of profitability, we expect a stable EBITDA margin in 2019 at 7.8% (from 8.2% in 2018) and a stabilisation of this level going forward, despite the growth in revenues. Concerning cash flow generation, we expect funds from operations (FFO) to grow to GEL 51m in 2019 from GEL40 m, despite our expectations of lower EBITDA growth. We forecast that free operating cash flow (FOCF) will remain negative in 2019, reflecting the heavy investment phase last year. FOCF should turn positive from 2020 on as the group focuses on more organic development.

In terms of ratios, leverage (measured by FFO/Scope-adjusted debt [SaD] and SaD/EBITDA) is well within the BB range, reaching 24% and 3.1x respectively at YE 2018. We expect the two values to improve over the next year to 26% and 2.9x. The relatively high interest cover should continue to support the financial risk profile, as we forecast a metric of 4.5x from 2019 on. As mentioned above, FOCF remains negative due to heavy capex originated by Nikora Trade and Nikora LLC, lowering the average of the metrics. Nonetheless, we expect a quick recovery from the -13% reached this year to -1% in 2019 and 15% in 2020.

Our assessment of liquidity is negative due to high short-term debt which is not covered by sufficient available liquidity. However, we expect this metric to recover somewhat to 8.3x at YE 2019, due to the repayment of the outstanding bond in June 2019 and other loans. We maintain a negative notch for liquidity because of limited visibility.

Due to the group structure, Nikora JSC is liable for the repayment of the bank debts of the entities within the group. In practice, TBC bank (the main loan lender) has solely affirmed monitoring the covenants of Nikora JSC, Nikora LLC (representing 2% only of the gross debt of the group) and Nikora Trade.

Outlook

Our rating Outlook is Stable and incorporates our view that Nikora JSC will maintain FFO/SaD between 20% and 30%.

A positive rating action could be triggered if FFO/SaD rises above 35% and liquidity improves sustainably.

A negative rating action could result if FFO/SaD falls below 20% and liquidity does not improve sustainably.

Rating drivers

Positive rating drivers	Negative rating drivers
• Relatively high interest cover • Excellent market positioning of the holding company as a key player in both retail and FMCG in Georgia • Good sectoral diversification and range of products offered	• Low FOCF due to a significant capex programme, putting pressure on liquidity • Group profitability remains low due to dilution by Nikora Trade

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FFO/SaD above 35% • Positive liquidity on a sustainable basis	• FOCF/SaD remaining below 20% • Liquidity remaining negative for a sustained period

Financial overview

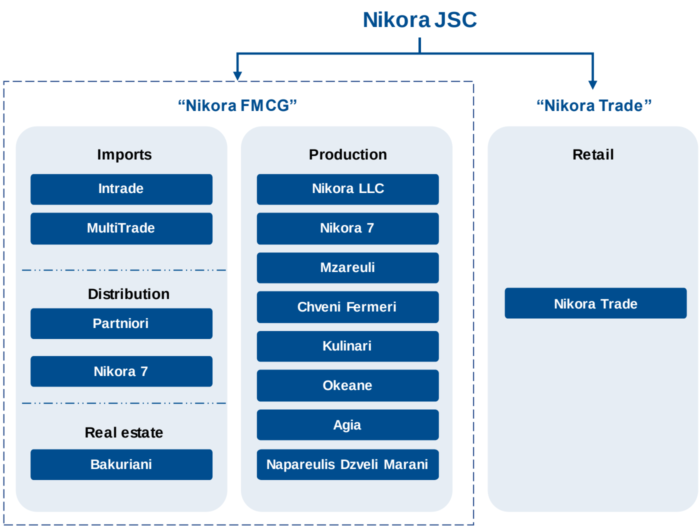
			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	4.0x	4.4x	4.5x	4.6x
SaD/EBITDA	3.1x	3.1x	2.9x	2.8x
Scope-adjusted FFO/SaD	23%	24%	26%	27%
FOCF/SaD	0%	-13%	-1%	11%
Scope-adjusted EBITDA in GEL m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	27,771.0	34,137.0	41,556.3	50,237.0
Operating lease payment in respective year	19,108.0	19,035.0	25,031.5	30,058.7
Other	-	-	-	-
Scope-adjusted EBITDA	46,879.0	53,172.0	66,587.8	80,295.7
Scope funds from operations in GEL m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	27,771.0	34,137.0	41,556.3	50,237.0
less: (net) cash interest as per cash flow statement	-7,771.0	-8,165.0	-9,856.2	-11,438.3
less: cash tax paid as per cash flow statement	-1,400.0	-1,750.0	-908.1	-1,270.4
add: depreciation component operating leases	15,286.4	15,228.0	20,025.2	24,047.0
Scope funds from operations	33,886.4	39,450.0	50,817.3	61,575.2
Scope-adjusted debt in GEL m	**2017**	**2018**	**2019F**	**2020F**
Reported gross financial debt	78,860.0	94,500.0	100,289.0	126,378.8
less: cash, cash equivalents	-10,734.0	-3,175.0	-7,186.6	-22,482.2
add: operating lease obligation	76,432.0	76,140.0	100,126.0	120,235.0
Scope-adjusted debt	144,558.0	167,465.0	193,228.4	224,131.5

Business risk profile

Composition of the holding company

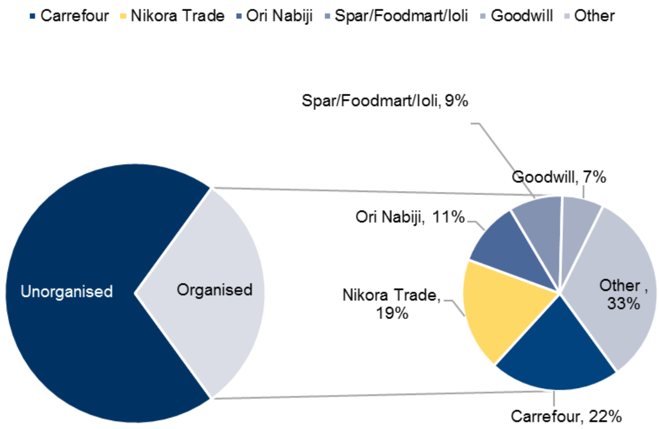
Thanks to its specific structure, Nikora JSC is active into two different industry sectors: retail (with Nikora Trade JSC, rated B+ by Scope) and in fast moving consumer goods (FMCG) with various entities, illustrated in Figure 1. In order to rate Nikora JSC's business risk profile, we aggregated all of the FMCG producing entities under one name 'Nikora FMCG' and assigned a subrating to this fictive entity. Once each subrating for the business risk profile had been defined, we obtained the final rating by using a weighted average based on the EBITDA of Nikora Trade and Nikora FMCG.

Figure 1: Organigram of the group



Source: Scope, Nikora Trade, Nikora JSC

Figure 2: Market share of Nikora Trade



Source: Scope, TBC Bank

Strong market positioning of the two segments

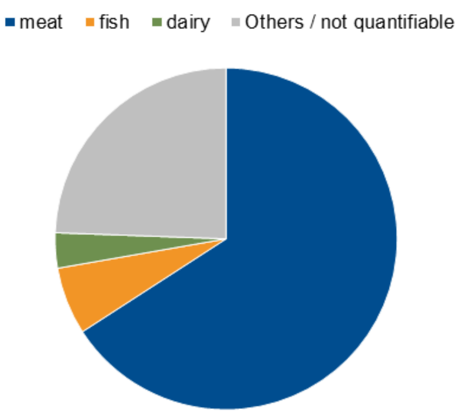
The two companies, Nikora Trade and Nikora FMCG, both benefit from high brand recognition in the country, leading to a relatively high market share in each of their sectors. Nikora FMCG, spearheaded by its meat production arm – Nikora LLC and Nikora 7 – benefits from close to 30% of the national production of meat. Although they are more minor players on the national scene, the other entities constituting Nikora FMCG make a large range of products, complementing Nikora FMCG's overall offer. Nikora Trade assesses its market share in the modern retail market as slightly below 20%, with Carrefour being the only larger entity in the country. We do not see the delays in Nikora Trade's shop expansion or the new focus on more organic growth as detrimental to the retailer's market position. This is because our assessment of Nikora Trade's growth rate was already cautious for our previous rating. Furthermore, the new strategy should lead to more stable margins going forward.

While the two entities appear to be nationally dominant, they remain relatively small in terms of the absolute market. In Georgia, a considerable share of food products are not sold by classic retailers, but rather via bazaars and unorganised markets, leading to a market share for Nikora Trade of under 5%, according to our estimations. We expect the unorganised market to shrink due to new regulations. At the same time, the bazaars are only expected to lose market share slowly, due to Georgians' cultural attachment to these traditional channels. Nikora JSC's presence in every segment of the food industry (from production to sales) makes it well positioned within the country, with relatively low risk of being substituted by local competitors.

Activities in two industries supports diversification

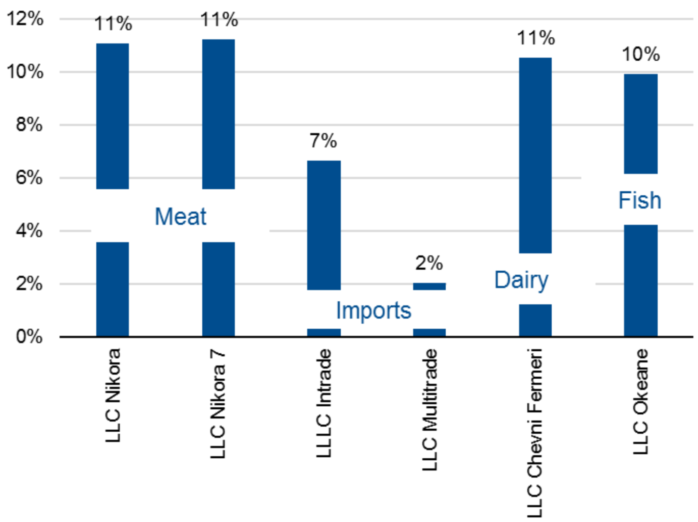
In terms of diversification, Nikora JSC benefits greatly from its footprint in the two aforementioned sectors, decreasing the holding company's overall risk. The combination ensures a vast range of customers (B2C via Nikora Trade through its shops and B2B via the various entities of Nikora FMCG which sell to retailers). Nikora FMCG sells close to 23% of its total products to Nikora Trade. The two entities are 'semi-integrated' but also have commercial agreements with the majority of the country's retailers, ensuring high overall diversification. We understand that the poorest performing entities can also be transformed into purely private label sources (fully integrated) for Nikora Trade, allowing the group increased flexibility to adapt products to customer demand. The diversity of edible products sold somewhat counterbalances the central weight of meat in sales. The group generates 66% of its revenue with meat, 3% with dairy, 6% with fish and the rest from other non-classifiable goods. Diversification is nonetheless constrained by the group's small geographical footprint although it does import raw materials and finished products from abroad.

Figure 4: Diversification of group sales by product



Source: Scope, Nikora JSC

Figure 4: Profitability of the different entities of Nikora JSC (based on unconsolidated figures)



Source: Scope, TBC Bank

Profitability of Nikora Trade supports the group

Profitability, the last criteria in our business risk profile rating, is seen as a positive rating driver for Nikora Trade but a negative one for Nikora FMCG. In fact, with a Scope-adjusted EBITDA margin of close to 10% at YE 2018, Nikora Trade is one of the most profitable food retailers in its peer group. The retailer benefits from a vast range of supermarket formats (from kiosks to convenience shops and medium supermarkets), ensuring a continuous assortment of products adapted to the needs of customers. On the other hand, Nikora FMCG's 10% profitability margin (estimated based on the reported EBITDA of non-consolidated figures) is low for a food producer. This is because the group traded some of its profitability for a higher market share, resulting in a certain resilience to new competitors in most segments. Going forward, we expect profitability to remain stable over 2019 and start increasing post 2020. In detail, we expect the high costs incurred by Nikora Trade's development strategy to have fallen by the end of 2019. This should reinforce the profitability linked to the new meat processing factory, built for Nikora LLC (and belonging to Nikora FMCG). We expect an EBITDA margin of 12.5% and above going forward.

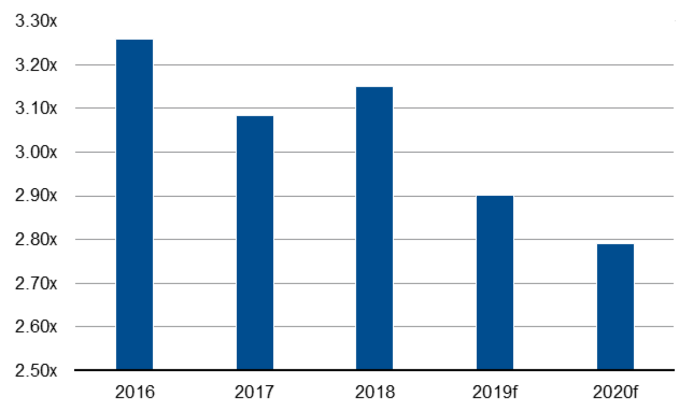
Financial risk profile

Scope forecasts

Our forecasts are based on different assumptions:

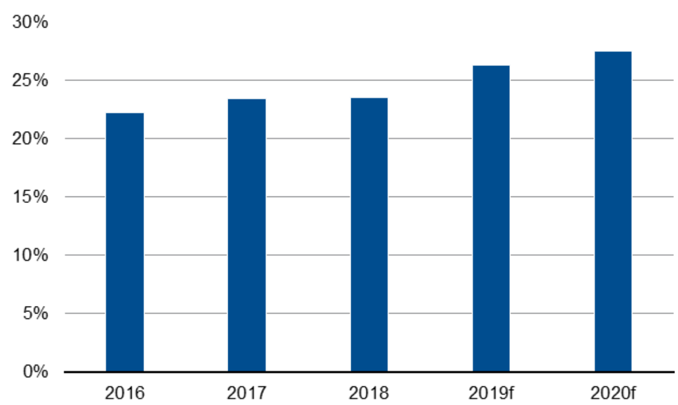
- Each entity borrows separately and each are linked via a system of cross guarantees. However, we have mainly monitored the debt and covenant levels of Nikora Trade, Nikora JSC and Nikora LLC because banks chiefly consider these companies when assessing group solvability. We believe that if any other group entity went into bankruptcy it would be easily bailed out by Nikora JSC.
- Increase in revenues bolstered by the development of Nikora Trade and the upcoming opening of the second meat producing factory. The group expects its own meat sales to grow at 10% annually primarily driven by the addition of new stores. We modelled 27% revenue growth for 2019, 20% in 2020, and 7% in 2021
- Gradual repayment of the debt incurred by Nikora Trade; however, Nikora JSC's holding is planning to tap the current bond (but this time in GEL instead of USD) and continue to serve as a borrowing entity for the rest of the group. Indebtedness will remain relatively high and decrease after YE 2020.
- Less capex weight on cash flows, due to the end of the heavy investment programme in YE 2019

Figure 5: Nikora JSC's evolution of SaD/EBITDA



Source: Scope, Nikora JSC

Figure 6: Nikora JSC's evolution of FFO/SaD



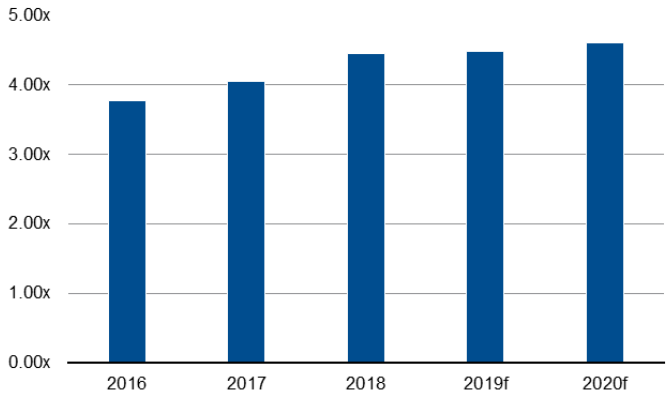
Source: Scope, Nikora JSC

Positive development of metrics going forward…

We consider leverage to be well within the BB range due to a SaD/EBITDA ratio close to 3x and FFO/SaD at 24% at the end of 2018. These ratios are forecasted to develop positively over the next years, despite our forecasts of an increase in gross debt and operating lease commitments. Indeed, the improvement in cash flows should lead to a higher recorded cash level, decreasing the growth of SaD going forward, while we expect both FFO and EBITDA to develop at a quicker pace. Leverage should develop positively going forward.

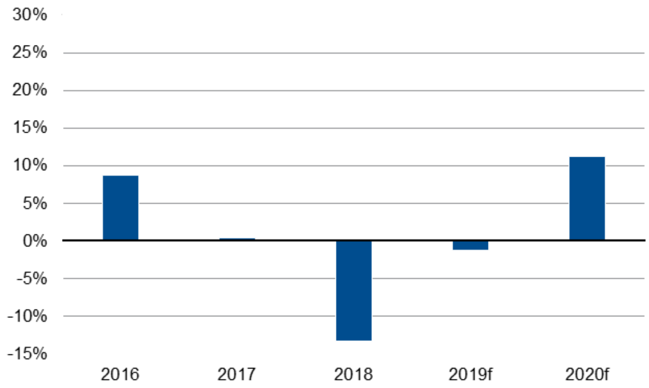
We expect a rise in Scope-adjusted interest in 2019, due to our expectations of an increase in gross debt – in the short term – added to a higher interest component of the operating leases agreements. We nonetheless forecast relatively stable interest cover at YE 2019, in line with YE 2018, due to a similar increase in EBITDA. The metric is well within the low BBB range.

Figure 5: Nikora Trade's evolution of interest cover



Source: Scope, Nikora JSC

Figure 6: Nikora Trade's evolution of FOCF/SaD



Source : Scope, Nikora JSC

… in addition to FOCF/SaD and liquidity which still burden the financial risk profile

FOCF was negative in 2018 and is expected to remain so in 2019, due to the group's high capex plans. While capex in these two years should be exceptional due to management's decision to focus more on organic growth, a more cautious approach would keep the metric in the B category.

Our assessment of liquidity is negative due to high short-term debt which is not covered by sufficient available liquidity. Nonetheless, due to the repayment of the outstanding bond in June 2019 together with other loans, we expect this metric to recover somewhat to 8.3x at YE 2019. We maintain a negative notch for liquidity due to limited visibility.

A careful overall approach to financial risk profile assessment

As well as taking metrics into consideration when assessing Nikora's financial risk profile, we also looked at additional elements from the company's overall financial environment. This supplementary screening led us to be more conservative in our assessment.

Outlook

Our rating Outlook is Stable and incorporates our view that Nikora Trade will maintain FFO/SaD between 20% and 30%.

A positive rating action could be triggered if FFO/SaD rises above 35% and liquidity improves sustainably.

A negative rating action could result if FFO/SaD falls below 20% and liquidity does not improve sustainably.

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